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## United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275


January 28, 2002

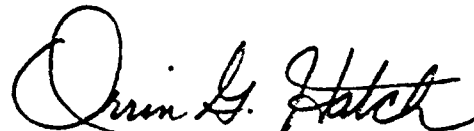
Ms. Renata Hesse  
Trial Attorney  
U.S. Department of Justice - Antitrust Division  
325 7<sup>th</sup> Street NW Suite 500  
Washington, D.C. 20530

Dear Ms. Hesse,

We enclose the hearing record from the Judiciary Committee's December 12, 2001 hearing, "The Microsoft Settlement: A Look to the Future," as a public comment pursuant to the Tunney Act's public comment provision, 15 U.S.C. § 16(d), for the Department's or the Court's use as it deems appropriate.

Sincerely,

  
PATRICK J. LEAHY  
Chairman

  
ORRIN G. HATCH  
Ranking Republican Member

SENATE COMMITTEE ON THE JUDICIARY  
DOCUMENTS FROM THE DECEMBER 12, 2001 HEARING ON  
"THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE"

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Charles F. Rule, Counsel to Microsoft Corporation  
Jonathan Zuck, Association for Competitive Technology  
Jay L. Himes, Office of the Attorney General, New York  
[As of 1/28/02, the Committee has not received answers to written questions from Dr. Cooper]

**Witness List**  
**Senate Committee on the Judiciary**  
**"The Microsoft Settlement: A Look to the Future"**  
**Wednesday, December 12, 2001**  
**10:00 a.m.**  
**106 Dirksen Senate Office Building**

**PANEL I**

**The Honorable Charles A. James**  
Assistant Attorney General for the Antitrust Division  
United States Department of Justice  
Washington, DC

**PANEL II**

**Jay Himes**  
Chief, Antitrust Bureau  
Office of the New York State Attorney General  
New York, NY

**Charles F. Rule**  
Fried, Frank, Harris, Shriver & Jacobson  
Counsel to Microsoft Corporation  
Washington, DC

**PANEL III**

**Professor Lawrence Lessig, Esq.**  
Stanford Law School  
Stanford, CA

**Mark N. Cooper, Ph.D.**  
Director of Research  
Consumer Federation of America  
Washington, DC

**Jonathan Zuck**  
President  
Association of Competitive Technology  
Washington, DC

**Matthew J. Szulik**  
President and Chief Executive Officer  
Red Hat, Inc.  
Durham, NC

**Mitchell E. Kertzman**  
President and CEO  
Liberate Technologies  
San Carlos, CA



# TRANSCRIPT OF PROCEEDINGS

UNITED STATES SENATE

\* \* \*

COMMITTEE ON THE JUDICIARY

\* \* \*

THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE

\* \* \*

Washington, D. C.

December 12, 2001

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## C O N T E N T S

STATEMENT OF:

PAGE

Hon. Charles A. James, Assistant Attorney General,  
Antitrust Division, United States Department of  
Justice, Washington, D.C.

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## 1 THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE

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3

WEDNESDAY, DECEMBER 12, 2001

4

United States Senate,

5

Committee on the Judiciary,

6

Washington, D.C.

7

The committee met, pursuant to notice, at 10:08 a.m.,

8

in room SD-106, Dirksen Senate Office Building, Hon. Patrick

9

J. Leahy, chairman of the committee, presiding.

10

Present: Senators Leahy, Kohl, Cantwell, Hatch, Kyl,

11

DeWine, Sessions, and McConnell.

12

The Chairman. Good morning. I just want to do a

13

little housekeeping here. I want to make sure the chairman

14

and ranking member of the Antitrust Subcommittee are here,

15

Senator Kohl and Senator DeWine, both of whom have done a

16

superb job for years in handling antitrust matters.

17

I told Senator DeWine earlier, and this will probably

18

cause a recall petition from the Republican Party in Ohio,

19

what a terrific job he did as chairman and then what a

20

terrific job Senator Kohl has done as chairman on antitrust

21

matters, and pointing out that they are issues of great

22

complexity and great importance to everybody here in the

23

Senate.

24

I have looked at the proposed settlement the Department

— 25

of Justice and nine States have transmitted to the district

1 court that is a plan for the conclusion of what has been  
2 really landmark antitrust litigation. But now it has got to  
3 pass the legal test set out in the Tunney Act if it is going  
4 to gain court approval, and that test is both simple and  
5 broad. It requires an evaluation of whether the proposed  
6 settlement is in the public interest.

7 There is significant difference of opinion over how  
8 well the proposed settlement passes this legal test. In  
9 fact, the States participating in the litigation against  
10 Microsoft are evenly split. Nine States joined in the  
11 proposed settlement and nine non-settling States presented  
12 the court with an alternative remedy.

13 As the courts wrangle with the technical and complex  
14 legal issues at stake in this case, this committee is  
15 conducting hearings to educate ourselves, but also to  
16 educate the public about what this proposed settlement  
17 really means for our high-tech industry and for all of us  
18 who use computers at work and at school and at home.

19 Scrutiny of the proposed settlement by this committee  
20 during the course of the Tunney Act proceeding is  
21 particularly important. The focus of our hearing today is  
22 to examine whether the proposed settlement is good public  
23 policy and not to go into the legal technicalities. The  
24 questions raised here and views expressed may help inform  
25 the court. I plan, with Senator Hatch, to forward to the

1 court the record of this hearing for consideration as the  
2 courts goes about the difficult task of completing the  
3 Tunney Act proceedings and the remedy sought by the non-  
4 settling States.

5 I am especially concerned that the district court take  
6 the opportunity seriously to consider the remedy proposal of  
7 the non-settling States, and to consider it before she makes  
8 her final determination on the other parties' proposed  
9 settlement. The insights of the other participants in this  
10 complicated and hard-fought case are going to be valuable  
11 additions to the comments received in the Tunney Act  
12 proceeding. I would hope they would help inform the  
13 evaluation whether the settlement is in the public interest,  
14 a matter which for many people is still an open question.

15 The effects of this case extend beyond simply the  
16 choices available in the software marketplace. The United  
17 States has long been the world leader in bringing innovative  
18 solutions to software problems, in creating new tools and  
19 applications for use on computers and the Web, and in  
20 driving forward the flow of capital into these new and  
21 rapidly growing sectors of the economy.

22 This creativity is not limited just to Silicon Valley.  
23 I think of my own home area, Burlington, Vermont. It ranks  
24 seventh in the Nation in terms of patent filings.  
25 Burlington is 38,000 people and it is in a county of about

1 130,000 people. This is not per-capita; this is actual  
— 2 filings--seventh in the Nation.

3 Whether the settlement proposal will help or hinder  
4 this process and whether the high-tech industries will play  
5 the important role they should in our Nation's economy is a  
6 larger issue behind the immediate effects of this proposal.

7 With that in mind, I intend to ask the representatives  
8 of the settling parties how their resolution of this  
9 conflict will serve the ends that the antitrust laws  
10 require. Our courts have developed a test for determining  
11 the effectiveness of a remedy in a Sherman Act case. The  
12 remedy must end the anticompetitive practices, it must  
13 deprive the wrongdoer of the fruits of the wrongdoing, and it  
14 must ensure that illegality never recurs. The Tunney Act  
15 also requires that any settlement of such a case serve the  
16 public interest.

17 Now, these are all high standards, but they are  
18 reasonable ones and people have dealt with them for years.  
19 In this case, the D.C. Circuit, sitting en banc and writing  
20 unanimously, found that Microsoft had engaged in serious  
21 exclusionary practices, to the detriment of their  
22 competitors, and thus to all consumers. So we have to  
23 satisfy ourselves that these matters have been addressed and  
24 redressed, or if they have not, why not.

— 25 I have noted my concern that the procedural posture of

1 this case not jeopardize the opportunity of the non-settling  
2 States to have their day in court, and not deprive the  
3 district court of the value of their views on appropriate  
4 remedies in a timely fashion.

5 In addition, I have two basic areas of concern about  
6 the proposed settlement. First, I find many of the terms of  
7 the settlement to be either confusingly vague, subject to  
8 manipulation, or, worse, both. Mr. Rule raised an important  
9 and memorable point when he last testified before this  
10 committee in 1997 during the very important series of  
11 hearings that were convened by Senator Hatch on competition  
12 in the digital age, hearings that helped shape a lot of  
13 thinking in the Senate.

14 Testifying about the first Microsoft-Justice Department  
15 consent decree, Mr. Rule said, "Ambiguities in decrees are  
16 typically resolved against the Government. In addition, the  
17 Government's case must rise or fall on the language of the  
18 decree; the Government cannot fall back on some purported  
19 'spirit' or 'purpose' of the decree to justify an  
20 interpretation that is not clearly supported by the  
21 language." So we take seriously such counsel. We would  
22 worry if ambiguity in the proposed settlement would  
23 jeopardize its enforcement.

24 Second, I am concerned that the enforcement mechanism  
25 described in the proposed decree lacks the power and the

1 timeliness necessary to inspire confidence in its  
2 effectiveness. Particularly in light of the absence of any  
3 requirement that the decree be read in broad remedial terms,  
4 it is especially important that we inquire into the likely  
5 operation of the proposed enforcement scheme and its  
6 effectiveness.

7 Any lawyer who has litigated cases--and, Mr. James,  
8 that would certainly include you--and any business person  
9 knows how distracting litigation of this magnitude can be.  
10 We all appreciate the value that reaching an appropriate  
11 settlement can have not only for the parties, but also for  
12 consumers who are harmed by anticompetitive conduct, and the  
13 economy.

14 I am the first one to say we would like some finality  
15 so that everybody involved, all parties, can know what the  
16 standards are and all consumers can know what they are.  
17 Because of that, I don't come to this hearing pre-judging  
18 the merits of this proposed settlement, but instead as one  
19 who is ready to embrace a good settlement that puts an end  
20 to the merry-go-round of Microsoft litigation over consent  
21 decrees.

22 The serious questions that have been raised about the  
23 scope, enforceability and effectiveness of this proposed  
24 settlement leave me concerned that if it is approved in its  
25 current form, it may simply be an invitation for the next



1 chapter of litigation.

2 I want an end to this thing. I think everybody wants  
3 an end to it, but we want an end to it where we know what  
4 the rules are going to be. If we don't know what the rules  
5 are going to be, as sure as the sun rising in the east we  
6 are going to face these issues again. On this point, I  
7 share the concern of Judge Robert Bork, who warns in his  
8 written submission that the proposed settlement "contains so  
9 many ambiguities and loopholes as to make it unenforceable  
10 and likely to guarantee years of additional litigation.

11 So I look forward to hearing from the Department of  
12 Justice and the other witnesses here. I will put into the  
13 record a series of letters: one, a letter to myself and  
14 Senator Hatch from James Barksdale; another, a letter to  
15 Assistant Attorney General James from Senator Hatch; a  
16 letter from Senator Hatch from Assistant Attorney General  
17 James; letters to myself and Senator Hatch from Robert Bork;  
18 a letter to myself from Ralph Nader, with two enclosures;  
19 written testimony of Catfish Software, Inc; and written  
20 testimony of Mark Havlicek of Digital Data Resources, Inc.

1 21 [The information referred to follows:]

1           The Chairman. I yield to Senator Hatch, who did such  
— 2       superb hearings on this whole issue earlier.

3           Senator Hatch. Well, thank you, Mr. Chairman. As you  
4       know, we conducted a series of hearings, as you have  
5       mentioned, in this committee in 1997 and 1998 to examine the  
6       policy implications of the competitive landscape of the then  
7       burgeoning high-tech economy and industry, which was about  
8       to explode with the advent of the Internet.

9           Those hearings focused on competition in the industry,  
10       in general, and more specifically complaints that Microsoft  
11       had been engaged in anticompetitive behavior that threatened  
12       competition and innovation, to the detriment of consumers.  
13       Our goal was, and I believe today is to determine how best  
14       to preserve competition and foster innovation in the high-  
15       technology industry.

16           Although the committee and I as its chairman was then  
17       criticized by some, I strongly believed then and continue to  
18       believe now that in a robust economy involving new  
19       technologies, effective antitrust enforcement today would  
20       prevent the need for heavy-handed Government regulation of  
21       business tomorrow.

22           My interest in the competitive marketplace in the high-  
23       technology industry was animated by my strong opposition to  
24       regulation of the industry, whether by government or by one  
— 25       or few companies. As we may remember, the hearings before

1 the Judiciary Committee developed an extensive record of  
2 Microsoft's conduct and evidenced various efforts by the  
3 company to maintain and extend its operating system  
4 monopoly. These findings, I would note, were reaffirmed by  
5 a unanimous and ideologically diverse Court of Appeals. The  
6 Microsoft case and its ultimate resolution present one of  
7 the most important developments in antitrust law in recent  
8 history, certainly in my memory.

9 As I have emphasized before, having a monopoly is not  
10 illegal under our laws. In fact, in a successful  
11 capitalistic system, striving to be one should be  
12 encouraged, as a matter of fact. However, anticompetitive  
13 conduct intended to maintain or extend this monopoly would  
14 harm competition and could possibly be violative of our  
15 laws.

16 I believe no one would disagree that the D.C. Circuit  
17 Court's decision reaffirmed the fundamental principle that a  
18 monopolist, even a monopolist in a high-tech industry like  
19 software, must compete on the merits to maintain its  
20 monopoly, which brings us to today's hearing. We are here  
21 to examine the policy implications of the proposed  
22 settlement in the Government's antitrust litigation against  
23 Microsoft.

24 Mr. Chairman, rather than closing the book on the  
25 Microsoft inquiry, the proposed settlement appears to be

1 only the end of the latest chapter. The settling parties  
— 2 are currently in the middle of the so-called Tunney Act  
3 process before the court, and the non-settling parties have  
4 chosen to further litigate this matter and last week filed  
5 their own proposed settlement. This has been a complex case  
6 with significant consequences for Microsoft, high-tech  
7 entrepreneurs, and the American public as well.

8 The proposed settlement between Microsoft and the  
9 Justice Department and nine of the plaintiff State attorneys  
10 general is highly technical. We have all been studying it  
11 and its impact with great interest. Each of us has heard  
12 from some, including some of our witnesses here today, that  
13 the agreement contains much that is very good. Not  
14 surprisingly, we have also heard and read much criticism of  
15 the settlement. These are complex issues, and I would hope  
16 today's hearing will illuminate the many questions that we  
17 have.

18 I should note that about two weeks ago I sent a set of  
19 detailed and extensive questions about the scope,  
20 interpretation, and intended effects of the proposed  
21 settlement to the Justice Department, naturally seeking  
22 further information on my part.

23 First, I want to commend the Department for getting the  
24 responses to these questions to me promptly. We received  
— 25 them yesterday. I think the questions, which were made

1 public, and the Department's responses could be helpful to  
— 2 each member in forming an independent and fair analysis of  
3 the proposed settlement.

4 To that end, and for the benefit of the committee, Mr.  
5 Chairman, I would like to make both the questions and the  
6 Department's answers part of the record for this hearing.  
7 So I would ask unanimous consent that they be made part of  
8 the record.

9 As I noted in my November 29th letter to the  
10 Department, I have kept an open mind regarding this  
11 settlement and continue to do so. I have had questions  
12 regarding the practical enforceability of the proposed  
13 settlement and whether it will effectively remedy the  
14 unlawful practices identified by the D.C. Circuit and  
15 restore competition in the software marketplace.

16 I am also cognizant of both the limitation of the  
17 claims contained in the original Justice Department  
18 complaint by the D.C. Circuit, as well as the standards for  
19 enforcement under settled antitrust law. I believe that  
20 further information regarding precisely how the proposed  
21 settlement will be interpreted, given D.C. Circuit case law,  
22 is necessary to any full and objective analysis of the  
23 remedies proposed therein. I hope that this hearing will  
24 result in the development of such information that would  
— 25 supplement the questions that I have put forth to the

1 Department.

— 2 Mr. Chairman, one important and critical policy issue  
3 that I would hope we can address today and that I would like  
4 all of our witnesses to consider as they wait to be  
5 empaneled so that they can discuss is the difficult issue of  
6 the temporal relation of antitrust enforcement in new high-  
7 technology markets.

8 It cannot be overemphasized that timing is a critical  
9 issue in examining conduct in the so-called "new economy."  
10 Indeed, the most significant lesson the Microsoft case has  
11 taught us is this fact. The D.C. Circuit found this issue  
12 noteworthy enough to discuss in the first few pages of its  
13 opinion, and I will quote from the unanimous court:

14 "[w]hat is somewhat problematic...is that just over six  
15 years have passed since Microsoft engaged in the first  
16 conduct plaintiffs allege to be anticompetitive. As the  
17 record in this case indicates, six years seems like an  
18 eternity in the computer industry. By the time a court can  
19 assess liability, firms, products, and the marketplace are  
20 likely to have changed dramatically. This, in turn,  
21 threatens enormous practical difficulties for courts  
22 considering the appropriate measure of relief in equitable  
23 enforcement actions." The court goes on to say, "Innovation  
24 to a large degree has already rendered the anticompetitive  
— 25 conduct obsolete (although by no means harmless)."

1 Now, this issue is one that is relevant for this  
— 2 committee to consider as a larger policy matter, as well as  
3 how it relates to this case and the proposed settlement we  
4 are examining today.

5 Let me just say that one of the things that worries me  
6 is what are the enforcement capabilities of this settlement  
7 agreement? It was only a few years before these matters  
8 arose that Microsoft had agreed to a consent, a conduct  
9 decree that many feel they did not live up to, and I think  
10 it is a legitimate issue to raise as to how will the  
11 agreement that the Justice Department has worked out with  
12 Microsoft and nine of the plaintiffs be enforced if  
13 anticompetitive conduct continues.

14 In that regard, let me just raise Mr. Barksdale's  
15 letter, which I believe you put into the record.

16 The Chairman. I did, I did.

17 Senator Hatch. Well, let me just raise it because he  
18 does make some interesting comments in his letter and I can  
19 read them, I think they might be at least part of opening up  
20 the questions in this matter. I will just quote a few  
21 paragraphs.

22 He says, "These developments have stiffened my resolve  
23 to do all I can to ensure that competition and consumer  
24 choice are reintroduced to the industry. It is vitally  
— 25 important that no company can do to a future Netscape what

1 Microsoft did to Netscape from 1995 to 1999. It is  
— 2 universally recognized that the 1995 consent decree was  
3 ineffective. I respectfully submit that the Proposed Final  
4 Judgment, PFJ, which is the subject of the hearing, will be  
5 even less effective, if possible, than the 1995 decree in  
6 restoring competition and stopping anticompetitive behavior.  
7 Accordingly, Senator Leahy, I am going to follow your  
8 suggestion that I help the committee answer one of the  
9 central questions. If the PFJ had been in effect all along,  
10 how would it have affected Netscape? More important, how  
11 will it affect future Netscapes?"

12 He describes the impact on future Netscapes as follows,  
13 and let me just read a couple of paragraphs in this regard.  
14 "As discussed in the attached document, the unambiguous  
15 conclusion is that if the PFJ agreed upon last month by  
16 Microsoft and the Department of Justice had been in  
17 existence in 1994, Netscape would have never been able to  
18 obtain the necessary venture capital financing. In fact,  
19 the company would not have come into being in the first  
20 place. The work of Mark Andreessen's team at the University  
21 of Illinois in developing the Mosaic browser would likely  
22 have remained an academic exercise. An innovative,  
23 independent browser company simply could not survive under  
24 the PFJ, and such would be the effect on any company  
— 25 developing in the future technologies as innovative as the



1 browser was in the mid-1990s."

— 2 He goes on to characterize whether or not Microsoft  
3 could have developed this itself, but let me just read the  
4 last few paragraphs of this letter.

5 "If the PFJ provisions are allowed to go into effect,  
6 it is unrealistic to think that anybody would ever secure  
7 venture capital financing to compete against Microsoft.  
8 This would be a tragedy for our Nation. It makes a mockery  
9 of the notion that the PFJ is 'good for the economy'  
10 unquote. If the PFJ goes into effect, it will subject an  
11 entire industry to dominance by an unconstrained monopolist,  
12 thus snuffing out competition, consumer choice, and  
13 innovation in perhaps our Nation's most important industry.  
14 And, worse, it will allow them to extend their dominance to  
15 more businesses such as financial services, entertainment,  
16 telecommunications, and perhaps many others. Four years  
17 ago, I appeared before the committee and was able to  
18 demonstrate, with the help of the audience, that Microsoft  
19 undoubtedly had a monopoly. Now, it has been proven in the  
20 courts that Microsoft not only has a monopoly, but they have  
21 illegally maintained that monopoly through a series of  
22 abusive and predatory actions. I submit to the committee  
23 that Microsoft is infinitely stronger in each of their core  
24 businesses than they were four years ago, despite the fact  
— 25 that their principal arguments have been repudiated 8-0 by

1 the Federal courts. I hope you will keep these thoughts in  
— 2 mind during your hearings." Then he said, "A more detailed  
3 analysis of my views follows."

4 Well, the importance of that letter is basically  
5 Barksdale was one of the original complainants against  
6 Microsoft and was one of the very important witnesses before  
7 this committee in those years when we were trying to figure  
8 what we are doing here. I don't think you can ignore that,  
9 and so these questions have to be answered that he raises,  
10 plus the questions that I have given as well.

11 So you have put that letter in the record?

12 The Chairman. I have, and also I understood you wanted  
13 those letters that you had to Mr. James. Those are also  
14 part of the record.

15 Senator Hatch. I appreciate it.

16 Let me just say, Mr. Chairman, I am grateful that you  
17 are continuing the committee's important role in high-  
18 technology policy matters, as I would expect you to do  
19 because I know that you take a great interest in these  
20 matters, as does, I think, every individual person on the  
21 committee.

22 I certainly look forward to hearing our witnesses  
23 today, and I am going to keep an open mind on where we are  
24 going here and hopefully we can resolve these matters in a  
— 25 way that is beneficial to everybody, including those who are

1 against Microsoft and Microsoft itself.

— 2 Thank you, Mr. Chairman.

3 The Chairman. Thank you.

4 Senator Kohl?

5 Senator Kohl. Mr. Chairman, we thank you for holding  
6 this hearing here today.

7 This is a crucial time for competition in the high-tech  
8 sector of our economy. After spending more than three years  
9 pursuing its groundbreaking antitrust case against  
10 Microsoft, the Government has announced a settlement. But  
11 the critical question remains, will this settlement break  
12 Microsoft's stranglehold over the computer software industry  
13 and restore competition in this vital sector of our economy?  
14 I have serious doubts that it will.

15 An independent Federal court, both the trial court and  
16 the Court of Appeals, found that Microsoft broke the law and  
17 that its violation should be fixed. This antitrust case was  
18 as big as they come. Microsoft crushed a competitor,  
19 illegally tried to maintain its monopoly, and stifled  
20 innovation in this market.

21 Now, after all these years of litigation, of charges  
22 and counter-charges, this settlement leaves us wondering,  
23 did we really accomplish anything. Or in the words of the  
24 old song, "is that all there is?" Does this settlement obey  
— 25 the Supreme Court mandate that it must deny the antitrust

1 violator the fruits of its illegal conduct?

— 2 It seems to me and to many, including nine of the  
3 States that joined the Federal Government in suing  
4 Microsoft, that this settlement agreement is not strong  
5 enough to do the job, to restore competition to the computer  
6 software industry. It contains so many loopholes,  
7 qualifications, and exceptions that many worry that  
8 Microsoft will easily be able to evade its provisions.

9 Today, for the vast majority of computer users, the  
10 first thing they see when they turn on their machine is the  
11 now familiar Microsoft logo, placed on the Microsoft start  
12 menu, and all of their computer operations take place  
13 through the filter of Microsoft's Windows operating system.  
14 Microsoft's control over the market is so strong that today  
15 more than 95 percent of all personal computers run on the  
16 Windows operating system, a market share high enough to  
17 constitute a monopoly under antitrust law.

18 Its share of the Internet browsing market is now over  
19 85 percent, and it reported a profit margin of 25 percent in  
20 the most recent quarter, a very high number in challenging  
21 economic times. Microsoft has the power to dictate terms to  
22 manufacturers who wish to gain access to the Windows  
23 operating system and the ability to leverage its dominance  
24 into other forms of computer software. And Microsoft has  
— 25 never been shy about using its market power.

1 Are we here today really confident that in five years  
2 this settlement will have had any appreciable impact on  
3 these facts of life in the computer industry? I am not.

4 We stand today on the threshold of writing the rules of  
5 competition in the digital age. We have two options. One  
6 option involves one dominant company controlling the  
7 computer desktop facing minor restraints that expire in five  
8 years, but acting as a gatekeeper to 95 percent of all  
9 personal computer users. The other model is the flowering  
10 of innovation and new products that resulted from the  
11 breakup of the AT&T telephone monopoly nearly 20 years ago.  
12 From cell phones to faxes, from long-distance price wars to  
13 the development of the Internet itself, the end of the  
14 telephone monopoly brought an explosion of new technologies  
15 and services that benefit millions of consumers everyday.  
16 We should insist on nothing less in this case.

17 In sum, any settlement in this case should make the  
18 market for computer software as competitive as the market  
19 for computer hardware is today. While there is nothing  
20 wrong with settling, of course, we should insist on a  
21 settlement that has an immediate, substantial and permanent  
22 impact on restoring competition in this industry.

23 I thank our witnesses for testifying today and we look  
24 forward to hearing your views.

25 The Chairman. Thank you.

1 Senator DeWine?

— 2 Senator DeWine. Mr. Chairman, thank you very much for  
3 holding this very important hearing concerning the  
4 Department of Justice's Proposed Final Judgment in its case  
5 against Microsoft.

6 Mr. Chairman, as we examine this judgment and attempt  
7 to imagine what it will mean for the future of competition  
8 in this market, we must keep in mind the serious nature of  
9 this case. According to the D.C. Circuit Court, Microsoft  
10 did, in fact, violate our antitrust laws. Their behavior  
11 hurt the competitive marketplace. This is something that we  
12 must keep in mind as we examine the Proposed Final Judgment.

13 This hearing is particularly important at this time  
14 because Federal law does require the district court to  
15 examine the proposed settlement and determine if it is, in  
16 fact, in the public interest. Federal law clearly allows  
17 the public to be heard on such matters. I believe that this  
18 forum today will further that process of public discussion.

19 The Court of Appeals in this case, relying on  
20 established Supreme Court case law, explained what an  
21 appropriate remedy in an antitrust case such as this one  
22 must seek to accomplish. It should unfetter the market from  
23 anticompetitive conduct, terminate the illegal monopoly, and  
24 deny the defendant the fruits of its violations. It is  
— 25 important, Mr. Chairman, that we examine whether the

1 proposed decree would, in fact, accomplish these goals.

— 2 There seems to be a great deal of disagreement about  
3 what the competitive impact of the decree will be. While  
4 the proposed settlement correctly, I believe, focuses  
5 primarily on the market for middleware, there has been a  
6 great deal of concern raised about the mechanism for  
7 enforcing such a settlement. Specifically, I think we need  
8 to discuss further whether the public interest would be  
9 better served with a so-called special master or some sort  
10 of other administrative mechanism, or whether the Justice  
11 Department could be more effective enforcing the decree on  
12 its own.

13 In addition to the Department of Justice's Proposed  
14 Final Judgment, we also have the benefit of another remedies  
15 proposal that has been submitted to the court by nine States  
16 that did not join with the Antitrust Division's proposal. I  
17 would like to hear from our witnesses about the role they  
18 believe this alternative proposal should play in the ongoing  
19 Tunney Act proceedings.

20 As I mentioned earlier, Mr. Chairman, the Court of  
21 Appeals directed that any remedy should seek to deny  
22 Microsoft the fruits of its illegal activities. One clear  
23 benefit Microsoft derived from its violations was the  
24 effective destruction of Netscape as a serious competitor  
— 25 and a decrease in Java's market presence. It is obviously

1 impossible to go back in time and resurrect the exact market  
— 2 structure that existed, but it is important to discuss how  
3 the proposed settlement deals with this problem.

4 I would also like to note for the record that Microsoft  
5 will be represented today by one of their outside counsel,  
6 Rick Rule, rather than an actual employee of the company.  
7 Mr. Rule is an outstanding antitrust lawyer. He is well  
8 qualified to testify on this issue and we certainly look  
9 forward to hearing his testimony today.

10 However, Mr. Chairman, I must say that I am  
11 disappointed that Microsoft chose not to send an actual  
12 officer of the company because it does not appear to  
13 represent, frankly, the fresh start that I think we were all  
14 hoping to begin today.

15 Finally, I would like to thank you, Mr. Chairman,  
16 Ranking Member Hatch, and Antitrust Subcommittee Chairman  
17 Kohl for all of your hard work in putting this hearing  
18 together and all of your work on this issue generally over  
19 the last few years.

20 I look forward to the testimony of our witnesses today  
21 and to the committee's continuing oversight of this very  
22 important issue.

23 The Chairman. Mr. James, there is a vote on the floor.  
24 I think there are two or three minutes left in the roll call  
— 25 vote. We are going to suspend while we go to vote, but I



1 think--

— 2 Senator McConnell. Mr. Chairman, I have a really brief  
3 statement. Could I make that before you adjourn?

4 The Chairman. You can.

5 Senator McConnell. Let me just say that this hearing  
6 and the accompanying media spectacle indicate the Microsoft  
7 case is the subject of significant public interest and  
8 debate. Some argue that the case itself should never have  
9 been filed to begin with, and now after nearly four years of  
10 litigation, Microsoft, the Department of Justice and nine  
11 States have reached a settlement.

12 I just want to commend the parties for their tireless  
13 effort and countless hours spent in reaching the compromise.  
14 Settlement is nearly always preferable to litigation, and  
15 regulation by the market is nearly always better than  
16 regulation by litigation, or the Government for that matter.

17 As far as what the public thinks, just this week a  
18 nationwide survey indicated that the U.S. Government and  
19 Microsoft agreed to settle the antitrust case. However,  
20 nine State AGs argued that the antitrust case against  
21 Microsoft should continue. Which statement do you agree  
22 with?

23 The U.S. economy and consumers would be better off if  
24 the issue were settled as soon as possible: 70 percent. The  
— 25 court should continue to investigate whether Microsoft

1 should be punished for its business activities: 24 percent.  
2 Not that the public is always determinative, but I thought  
3 that would be an interesting observation to add.

4 Thank you very much, Mr. Chairman.

5 The Chairman. Mr. James, I think you would note from  
6 the comments that they sort of go across the board here.  
7 The majority of people favor a settlement, but I must say  
8 that I don't think the majority of people favor any  
9 settlement; they favor a good settlement, and that is what  
10 the questions will be directed at and that is why nine  
11 attorneys general have expressed concern. Nine agreed with  
12 the settlement, nine disagreed with the settlement. These  
13 are all very good, very talented people. So in your  
14 testimony when we come back, you have heard a number of the  
15 questions that have been raised and we look forward to you  
16 responding to them.

17 We will stand in recess while we vote.

18 [The committee stood in recess from 10:40 a.m. to 11:14  
19 a.m.]

20 The Chairman. I should note for the record that Mr.  
21 James has served as the Assistant Attorney General for the  
22 Antitrust Division since June 2001. He previously served as  
23 Deputy Assistant Attorney General for the Antitrust Division  
24 for the first Bush administration from 1989 to 1992. He  
25 served as Acting Assistant Attorney General for several

1 months in 1992, then was head of the antitrust practice at  
— 2 Jones, Day, Reavis and Pogue, in Washington.

3 Not knowing what the Senate schedule might be, Mr.  
4 James, we will put your whole statement in the record, of  
5 course. I wonder if you might summarize it, but also with  
6 some reference to the charge made in the letter to Senator  
7 Hatch and myself by Mr. Barksdale, who said had these been  
8 the ground rules, he never would have been able to get  
9 Netscape off the ground. Had these been the ground rules at  
10 the time they started Netscape, they never would have been  
11 able to create Netscape. If that is accurate, of course,  
12 then we have got a real problem.

13 So, Mr. James, it is all yours.

1 STATEMENT OF HON. CHARLES A. JAMES, ASSISTANT  
2 ATTORNEY GENERAL, ANTITRUST DIVISION, UNITED  
3 STATES DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

4 Mr. James. Thank you, Senator Leahy, and good morning  
5 to you and members of the committee. I am pleased to appear  
6 before you today to discuss the proposed settlement of our  
7 still pending case against Microsoft Corporation.

8 With me today are Deborah Majoris, my deputy, and Phil  
9 Malone, who has been the lead staff lawyer on the Microsoft  
10 case from the very beginning. I note their presence here  
11 because they were the ones who responded to the judge's  
12 order that we negotiate around the clock and I think they  
13 have recovered now.

14 As you know, on November 2 the Department and nine  
15 States entered into the proposed settlement. We are in the  
16 midst of the Tunney Act period, as you know, and that will  
17 end at the end of January, at which point the district court  
18 will determine whether the settlement is in the public  
19 interest. We think that it is.

20 I am somewhat limited in what I can say about the case  
21 because of the pendency of the Tunney Act proceeding. But,  
22 of course, I am happy to discuss this with the committee for  
23 the purpose of public explication.

24 When thinking about the Microsoft case, from my  
25 perspective it is always important to distinguish between

1 Microsoft, the public spectacle, and Microsoft, the actual  
2 legal dispute. We look, in particular, to what the  
3 Department alleged in its complaint and how the court ruled  
4 on those allegations.

5 The Antitrust Division's complaint had four counts:  
6 attempted monopolization of the browser market, in violation  
7 of Section 2; individual anticompetitive acts and a course  
8 of conduct to maintain the operating system monopoly, in  
9 violation of Section 2 of the Sherman Act; tying its own  
10 browser to the operating system, in violation of Section 1;  
11 and exclusive dealing, in violation of Section 1.

12 I would note that a separate monopoly leveraging claim  
13 brought by the States was thrown out prior to trial, and  
14 that the States at one time had alleged in their complaint  
15 monopolization of the Microsoft office market, and that was  
16 eliminated by the States through an amendment.

17 There was, of course, a trial before Judge Jackson, at  
18 the conclusion of which Judge Jackson found for the  
19 Government on everything but exclusive dealing and ordered  
20 Microsoft to be split into separate operating system and  
21 applications businesses after a one-year transitional period  
22 under interim conduct remedies.

23 On appeal, however, only the monopoly maintenance claim  
24 survived unscathed. The attempted monopoly claim was  
25 dismissed. The tying claim was reversed and remanded for

1 further proceedings under a much more rigorous standard.

— 2 And the remedy was vacated, with the court ordering remedial  
3 hearings before a new judge to address the fact that the  
4 liability findings had been, in their words, "drastically  
5 curtailed."

6 Even the monopoly maintenance claim was cut back in the  
7 Court of Appeals decision. The Court of Appeals found for  
8 Microsoft on some of the specific practices and ruled  
9 against the Government on the so-called course of conduct  
10 theory of liability.

11 I recount all of this history to make two basic points  
12 that I think are important as we discuss the settlement.  
13 First, the case, even as initially framed by the Department  
14 of Justice, was a fairly narrow challenge. It was never a  
15 direct assault on the acquisition of the operating system  
16 monopoly itself.

17 Second, and perhaps much more important, the case that  
18 emerged from the Court of Appeals was much narrower still,  
19 focusing exclusively on the middleware threat to the  
20 operating system monopoly and specific practices, not a  
21 course of conduct found to be anticompetitive.

22 The Court of Appeals decision determined the reality of  
23 the case as we found it in the Department when I first  
24 arrived there in June, as you noted. The conduct found to  
— 25 be unlawful by the court was the sole basis for relief.

1           It is probably worth talking just briefly about the  
— 2 monopoly maintenance claim. The complaint alleges that  
3 Microsoft engaged in various anticompetitive practices to  
4 impede the development of rival Web browsers and Java.  
5 These products came to be known as middleware and were  
6 thought to pose a threat to the operating system monopoly  
7 because they had the potential to become platforms for other  
8 software applications. The court noted that the middleware  
9 threat was nascent; that is to say that no one could predict  
10 when, if ever, enough applications would be written to  
11 middleware for it to significantly displace the operating  
12 system monopoly.

13           A few comments about the settlement itself. In general  
14 terms, our settlement has several important points that we  
15 think fully and demonstrably remedy the middleware issues  
16 that were at the heart of the monopoly maintenance claim.

17           In particular, our decree contains a very broad  
18 definition of middleware that specifically includes the  
19 forms of platform software that have been identified as  
20 potential operating system threats today and likely to  
21 emerge as operating system threats in the future. It  
22 prohibits in the broadest terms the types of contractual  
23 restrictions and exclusionary arrangements the Court of  
24 Appeals found to be unlawful. It fences in those  
— 25 prohibitions with appropriate non-discrimination and non-

1 retaliation provisions, and it creates an environment in  
2 which middleware developers can create programs that compete  
3 with Microsoft on a function-by-function basis through a  
4 regime of mandatory API documentation and disclosure.

5 In the most simple terms, we believe our remedy will  
6 permit the development and deployment of middleware products  
7 without fear of retaliation or economic disadvantage. That  
8 is what we believe and what the court found that consumers  
9 actually lost through Microsoft's unlawful conduct, and that  
10 is what we think consumers will gain through our remedy.

11 With specific reference to what Mr. Barksdale said, if  
12 I may, I have not reviewed Mr. Barksdale's letter. I know  
13 that in this particular situation, with so much at stake in  
14 this particular settlement, I have seen lots of hyperbolic  
15 statements. I certainly wouldn't necessarily characterize  
16 his in that vein without having read it in some detail.

17 I would note, however, that--

18 The Chairman. Mr. James, we are going to give you an  
19 opportunity to do that because I want you to look at it.  
20 You can feel free to call it hyperbolic or however, but I  
21 would ask that you and your staff look at his letter, which  
22 does raise some serious questions, and I would like to see  
23 what response you have for the record.

24 Mr. James. I would be happy to do so. And with that,  
25 I would be happy to answer your questions.



1 The Chairman. Did you have more that you wanted to say  
— 2 on the letter?

3 Mr. James. No, sir. I am happy to respond to what you  
4 folks want to talk about.

5 The Chairman. The Department of Justice has been  
6 involved in litigation against Microsoft for more than 11  
7 years. I am one of those who had hoped throughout that that  
8 the parties might come to some conclusion. I think that if  
9 you can have a fair conclusion, it is in the best interests  
10 of the consumers, the Government, Microsoft, competitors,  
11 and everybody else. I have no problem with that, but that  
12 presupposes the right kind of settlement.

13 Over the course of those 11 years, the parties entered  
14 into one consent decree that just ended up with a whole lot  
15 more litigation over the terms of that consent decree. I  
16 mention that because you take this settlement and it is  
17 already being criticized by some for the vagueness of its  
18 terms and its loopholes. Judge Robert Bork warned, and I  
19 think I am quoting him correctly, "It is likely to guarantee  
20 years of additional litigation."

21 Now, what kind of assurances can you give or what kind  
22 of predictions can you give that if this settlement is  
23 agreed to by the court that we are going to see an end to  
24 this litigation and we are going to have a stop to this kind  
— 25 of merry-go-round of Microsoft litigation concerning

1 compliance or even the meanings of the consent decree?

— 2 I notice a lot of people in this room on both sides of  
3 the issue. I have a feeling that they are here solely  
4 because of their interest in Government and not because the  
5 meter is running. A lot of us would like to see this thing  
6 end, but why do you feel that this settlement is so good  
7 that that is going to end?

8 Mr. James. Well, Senator, that is certainly a  
9 legitimate question and I understand the spirit in which it  
10 is asked. One of, I think, the facts of life is that one of  
11 the reasons that we have so many antitrust lawyers, and  
12 perhaps why there are so many of them in this room, is that  
13 firms with substantial market positions very often are the  
14 subject of appropriate antitrust scrutiny, and so it is with  
15 Microsoft and so it should be.

16 Our settlement here is a settlement that resolves a  
17 fairly complex piece of litigation. It by its terms is  
18 going to be a complex settlement, inasmuch as it does cover  
19 a broad range of activities and has to look into the future  
20 prospectively in a manner that benefits consumers. And some  
21 of that consumer benefit certainly will come from the  
22 development of competing products. Some of that consumer  
23 benefit, however, will come from competition from Microsoft  
24 as it moves into other middleware products, et cetera.

— 25 We think that the terms of the decree are certainly

1 enforceable. I think so much of what has been called a  
— 2 loophole are things that are carve-outs necessary to  
3 facilitate pro-competitive behavior, and we certainly think  
4 that the enforcement power embodied in this decree--I would  
5 say an unprecedented level of enforcement power, three tiers  
6 of enforcement power--is sufficiently to let the Department  
7 of Justice do its job.

8 The Chairman. But keep in mind that usually in these  
9 kinds of decrees, if it is not specifically laid out, the  
10 courts tend to decide the vague questions against the  
11 Government, not for the Government. Fortune Magazine said  
12 even the loopholes have loopholes--a pretty strong statement  
13 from a very pro-business magazine. The settlement limits  
14 the types of retaliation Microsoft can take against PC  
15 manufacturers that want to carry or promote non-Microsoft  
16 software, but some would say that it gives a green light to  
17 other types of retaliation.

18 Now, why doesn't the settlement ban all types of  
19 retaliation? The Court of Appeals said twice that if you  
20 commingle the browser and operating system code, you violate  
21 Section 2 of the Sherman Act. The proposed settlement  
22 contains no prohibition on commingling code. There is no  
23 provision barring the commingling of browser code and the  
24 operating code. So you have got areas where they can  
— 25 retaliate. You don't have the barring of this commingling

1 of code.

— 2 I mean, are Fortune Magazine, Judge Bork and others  
3 justified in thinking there are a few too many loopholes  
4 here, notwithstanding the levels of enforcement?

5 Mr. James. Let me take your points in order. First,  
6 on the subject of retaliation, retaliation is a defined term  
7 in this decree. It is a term that we are using to define a  
8 sort of conduct that Microsoft can engage in when it engages  
9 in ordinary commercial transactions.

10 I don't think that there is any scope in the bounds of  
11 this case to prohibit Microsoft from engaging in any form of  
12 collaborative conduct with anyone in the computer industry,  
13 and certainly the types of collaborative conduct that are  
14 permitted, the so-called loopholes, are the type of conduct  
15 that is permitted under standard Supreme Court law embodied  
16 in decisions like Broadcast Music v. NCAA, and also embodied  
17 in the Federal Trade Commission-Department of Justice joint  
18 venture guidelines as sanctioned forms of conduct. So we  
19 think that antitrust lawyers certainly can understand these  
20 types of issues and we think the courts can understand these  
21 types of issues.

22 Secondly, with regard to your more particular point  
23 about commingling code, it is certainly the case that the  
24 Court of Appeals, following upon the district court  
— 25 decision, found that Microsoft had engaged in an act of

1 monopolization in that it commingled code for the purpose of  
— 2 preventing the Microsoft browser from being removed from the  
3 desktop. That is certainly the finding of the Court of  
4 Appeals.

5 Now, in the process of going through my preparation for  
6 this hearing, I went back and looked at the Department of  
7 Justice's position with regard to this. Throughout the  
8 course of the case, and even in the contempt proceeding  
9 involving the former tying claims, it has always and  
10 consistently been the Department of Justice's contention  
11 that it did not want to force Microsoft to remove code from  
12 the operating system. They have said that over and over  
13 again in every brief that has been filed in this case.

14 What the Department of Justice wanted was an  
15 appropriate functionality that would give consumers the  
16 choice between middleware functionalities. That is exactly  
17 the remedy that we have here and we think it is an effective  
18 remedy. We have gone beyond that particular aspect of this  
19 by including into our decree a specific provision that deals  
20 with the questions of defaults; in other words, the extent  
21 to which a non-Microsoft middleware product can take over  
22 and be invoked automatically in place of a Microsoft  
23 middleware product. That is something that was not in the  
24 earlier decrees. It is a step beyond what was included in  
— 25 Judge Jackson's order.

1           We think that we have addressed the product integration  
— 2       aspects of the Microsoft monopoly maintenance claim in  
3       exactly the terms that the Department has always pursued  
4       with regard to that particular issue, and we are completely  
5       satisfied with that aspect of the relief.

6           The Chairman. Well, I have a follow-up on that, as you  
7       probably expect, but my time is up and I want to yield to  
8       Senator DeWine. Actually, I have a follow-up on the  
9       retaliation, also, but I do appreciate your answer.

10          Senator DeWine?

11          Senator DeWine. Thank you, Mr. Chairman.

12          Mr. James, this case has been certainly very  
13       controversial and inspired a great deal of discussion  
14       regarding the effectiveness of the antitrust laws,  
15       especially within the high-tech industry.

16          Netscape, for example, vocally opposed Microsoft during  
17       this litigation. Many of Netscape's complaints really were  
18       validated by the courts, and yet Netscape ended up losing  
19       the battle. This sort of result has led some to question  
20       whether our antitrust laws can be effective in this  
21       particular industry.

22          I personally believe that the antitrust laws are  
23       essential to promoting competition within the industry and  
24       throughout the country, but I would like to hear what your  
— 25       views are on this subject. What lessons do you think this

1 case teaches us in regard to that and what do we say to  
— 2 people like Netscape?

3 Mr. James. Well, it is certainly the case that our  
4 judicial system very often can provide a crude tool for  
5 redressing particular issues quickly. I would note that  
6 this particular case was litigated on a very fast track and  
7 the people at the Department of Justice are to be really  
8 commended for pushing this case along at even the speed that  
9 it is has taken, considering the comparable speed of other  
10 cases.

11 I think, however, that the case stands for an important  
12 proposition, and that is that the Department of Justice is  
13 up to meeting the challenge, that it has the tools at its  
14 disposal to investigate unlawful conduct, to understand and  
15 appreciate the implications of what complex technical  
16 matters involve, to bring the resources to bear in order to  
17 litigate these cases to a successful conclusion, and, where  
18 appropriate, to teach a settlement that is in the public  
19 interest.

20 One of the things that I think is an important issue to  
21 note here is that there is certainly a time difference  
22 between litigating a matter of original liability and  
23 litigating a matter involving compliance with a term of a  
24 decree.

— 25 We think that the enforcement powers that are involved

1 here are appropriate ones. We think that enforcement by the  
2 Department of Justice is the appropriate way to proceed in  
3 these matters, and we are confident that this provides the  
4 sort of best mechanism for dealing with a complex matter in  
5 complex circumstances.

6 Senator DeWine. One provision of the Proposed Final  
7 Judgment requires Microsoft to allow computer manufacturers  
8 to enable access to competing products. However, for a  
9 product to qualify for these protections, it must have had a  
10 million copies distributed in the United States within the  
11 previous year. This would seem to me to run contrary to the  
12 traditional antitrust philosophy of promoting new  
13 competition.

14 Why are these protections limited to larger  
15 competitors?

16 Mr. James. I am actually glad you asked that question,  
17 Senator, because that is one of the prevailing, I think,  
18 misconceptions of the decree. The provisions of the decree  
19 that require Microsoft to allow an OEM to place a middleware  
20 product on the desktop apply without regard to whether or  
21 not that product has been distributed by one million people.  
22 That is absolute requirement.

23 The million-copy distribution provision relates solely  
24 to the question of when Microsoft must undertake these  
25 affirmative obligations to create defaults, for example, for



1 a middleware product to provide other types of assistance to  
— 2 someone who has developed that product.

3 The fact of the matter is that this is something that  
4 requires a great deal of work, particularly these complex  
5 matters of setting defaults which is very important to the  
6 competitive circumstances here. And it would be very  
7 difficult to impose upon Microsoft the responsibility for  
8 making these alterations to the operating system and making  
9 them for every subsequent release of the operating system to  
10 be automatic in the case of any software company that just  
11 shows up and says I have a product that competes.

12 But I want to be very clear here, Senator. Every  
13 qualifying middleware product, without regard to how many.  
14 copies it has distributed--an OEM can place that product on  
15 the desktop immediately, without regard to this one-million  
16 threshold.

17 Quite frankly, in today's world, one million copies  
18 distributed is not a substantial matter. I think in the  
19 last year I might have gotten a million copies of AOL 5.0 in  
20 the mail. So I don't think that that is really a very large  
21 impediment.

22 Senator DeWine. Let me ask one last question. You  
23 have mentioned that a number of provisions in the settlement  
24 go beyond the four corners of the case, but Microsoft agreed  
— 25 to these conditions anyway.

1           What are they, and what is the goal of these  
— 2       provisions?

3           Mr. James. Well, I think one of the most important  
4       ones is the default provision. As of the time of our  
5       original case, these middleware products were operated in a  
6       fairly simple way. You clicked on to that product, you  
7       invoked that product, and then you used it in whatever way  
8       was appropriate.

9           In today's world, software has changed. We see what  
10      they call a more seamless user interface, user experience,  
11      and it is necessary for people to operate deeply within the  
12      operating system on an integrated basis. There were  
13      allegations that Microsoft overrode consumer choice in these  
14      default mechanisms in the case.

15          With regard to each and every one of those instances  
16      alleged by the Justice Department, the Justice Department  
17      lost. The court found for Microsoft. Notwithstanding that,  
18      as a matter of fencing in and improving the nature of this  
19      decree, we have included into this issue the subject of  
20      defaults.

21          Another important area, I think, is the question of  
22      server interoperability, and that is a very, very important  
23      issue as we see going forward. I think if you go back and  
24      read the complaint in this case, you will find that the word  
— 25      "server" almost virtually never appears. There are no sort

1 of very specific allegations that go to this. We thought  
— 2 this was an important alternative platform issue. We  
3 thought it was important to stretch for relief in this case,  
4 and we did so and got, I think, relief that is very  
5 effective in preserving this as people go into an  
6 environment of more distributed Web processing. So we think  
7 that that is a very powerful thing.

8 I think these are two issues that the Department of  
9 Justice would have had a very, very difficult time  
10 sustaining in court, to the extent the court was inclined to  
11 limit us to the proof that we put forward. So I think that  
12 these are very positive manifestations of the settlement.

13 Senator DeWine. Thank you, Mr. Chairman.

14 The Chairman. We are checking one thing, and I mention  
15 this to Senator Kohl, Senator Sessions, and Senator  
16 Cantwell, who have been here waiting to ask questions. We  
17 are finding out from the floor. We have been notified that  
18 there may have been a move, as any Senator has a right to do  
19 under our Senate rules, to object to committees meeting more  
20 than two hours after the Senate goes in session.

21 We are on the farm bill and appropriations and other  
22 essential matters, so that I have been told that a Senator  
23 has objected, as every Senator has a right to do, to us  
24 continuing. As a result, because the Senators say they want  
— 25 us to concentrate on what is going on on the Senate floor,

1 we have to respect the rules of the Senate. I do, and I am  
— 2 going to have to recess this hearing at this time.

3 I am going to put into the record the statements of all  
4 those who have come here to testify.

2 5 [The prepared statement of Mr. James follows:]

vr

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3 1 [The prepared statements of Messrs. Himes, Rule,  
— 2 Lessig, Cooper, Zuck, Szulik, and Kertzman follow:]

1 The Chairman. Senator Hatch and I will try to find a  
— 2 time we might reconvene this hearing, because both Senator  
3 Hatch and I feel this is a very important hearing.

4 The record will be open for questions that might be  
5 submitted. I apologize to everybody. We did not anticipate  
6 this. But with 100 Senators, every so often somebody  
7 exercises that rule. I would emphasize Senators have the  
8 right to exercise that rule, especially when we are in the  
9 last three weeks of the session. I think we are going to  
10 break for Christmas Day, but we are in the last three weeks  
11 of the session, and I think the Senator invoking the rule  
12 wants to make sure all Senators pay attention to the work on  
13 the floor.

14 Senator Hatch. Mr. Chairman?

15 Senator Sessions. Mr. Chairman?

16 The Chairman. We really are technically out of time,  
17 but Senator Hatch?

18 Senator Hatch. Mr. Chairman, we are out of time. Any  
19 Senator can invoke the two-hour rule and a Senator has done  
20 that. Fortunately, I think it was against the Finance  
21 Committee markup today, but we reported out the bill anyway  
22 right within the time constraint. That is where I went.

23 Both Senator Leahy and I apologize to the witnesses who  
24 have put such an effort into being here today because this  
— 25 is an important hearing. These are important matters to

1 both sides--to all sides, I should say; there are not just  
2 two sides here. These matters have a great bearing on just  
3 how positively impactful the United States is going to be in  
4 these areas.

5 So I hope that we can reconvene within a relatively  
6 short period of time and continue this hearing because it is  
7 a very, very important hearing. We apologize to you that  
8 this has happened, but as Senator Leahy has said, a Senator  
9 can do that.

10 The Chairman. Well, it is out of our hands, but I  
11 would note that normally I would have recessed it until  
12 tomorrow, but tomorrow we are using this time for an  
13 executive committee meeting of the Judiciary Committee to  
14 do, as we have done many times already, to vote out a large  
15 number of judges.

16 So with that, we stand in--Jeff, I am sorry.

17 Senator Sessions. Just, Mr. Chairman, a matter of  
18 procedure. I am troubled by what I understand to be a  
19 decision to send this transcript to the court as an official  
20 document from Congress in the middle of a litigation that is  
21 ongoing.

22 I would think that anybody's statement that they gave  
23 could be sent to the court. Any Senator can write a letter  
24 to the court. I haven't studied it fully, but just as a  
25 practitioner, it troubles me to have a meddling--

1           The Chairman. That record is open to anybody who wants  
— 2       to send anything in. Senator Hatch and I have made that  
3       decision and that will be the decision of the committee.

4           Senator Sessions. I would be recorded as objecting.

5           The Chairman. Of course, I understand.

6           We stand adjourned.

7           [Whereupon, at 11:43 a.m., the committee was  
8       adjourned.]



**Statement of Senator Patrick Leahy,  
Chairman, Senate Committee on the Judiciary  
Hearing  
"The Microsoft Settlement: A Look to the Future"  
December 12, 2001**

The proposed settlement that the Department of Justice and nine States have transmitted to the District Court offers a plan for the conclusion of this landmark antitrust litigation. It must now pass the legal test set out in the Tunney Act to gain court approval. That test is both simple and broad, and requires an evaluation of whether the proposed settlement is in the public interest.

There is significant difference of opinion over how well the proposed settlement passes this legal test. In fact, the States participating in the litigation against Microsoft are evenly split, with nine States joining in the proposed settlement and nine non-settling States presenting the court with an alternative remedy. As the courts wrangle with the technical and complex legal issues at stake in the case, this committee is conducting hearings to educate ourselves and the public about what this proposed settlement really means for our high-tech industry and for all of us who use computers at work, at school, and at home.

Scrutiny of the proposed settlement by this committee during the course of the Tunney Act proceeding is particularly important. The focus of our hearing today is to examine whether the proposed settlement is good public policy and not on the legal technicalities. The questions raised here and views expressed may help inform the court. I plan with Senator Hatch to forward to the court the record of this hearing for consideration as the court goes about the difficult task of completing the Tunney Act proceedings and the remedy action by the non-settling States.

I am especially concerned that the District Court take the opportunity seriously to consider the remedy proposal of the non-settling States before making her final determination on the other parties' proposed settlement. The insights of the other participants in this complicated and hard-fought case will surely be valuable additions to the comments received in the Tunney Act proceeding and help inform the evaluation whether the settlement is in the public interest.

The effects of this case extend beyond simply the choices available in the software marketplace. The United States has long been the world leader in bringing innovative solutions to software problems, in creating new tools and applications for use on computers and the Web, and in driving forward the flow of capital into these new and rapidly growing sectors of the economy. This creativity is not limited to Silicon Valley. The Burlington, Vermont, area ranks seventh in the nation in terms of patent filings. Whether the settlement proposal will help or hinder this process, and whether the high tech industries will play the important role that they should in our Nation's economy, is a larger issue behind the immediate impact of this proposal.

With that in mind, I intend to ask the representatives of the settling parties how their resolution of this conflict will serve the ends that the antitrust laws require. Our courts have developed a test for determining the effectiveness of a remedy in a Sherman Act case: The remedy must end the anticompetitive practices, it must deprive the wrongdoer of the fruits of the wrongdoing, and it

must ensure that the illegality does not recur. The Tunney Act also requires that any settlement of such a case serve the public interest. These are all high standards, but they are reasonable ones. In this case, the D.C. Circuit, sitting en banc and writing unanimously, found that Microsoft had engaged in serious exclusionary practices, to the detriment of their competitors and, thus, to all consumers. Today, we must satisfy ourselves that these matters have been addressed and redressed, or find out why not.

I have noted my concern that the procedural posture of this case not jeopardize the opportunity of the non-settling States to have their "day in court" and not deprive the District Court of the value of their views on appropriate remedies in a timely fashion. In addition, I have two basic areas of concern about the proposed settlement. First, I find many of the terms of the settlement to be either confusingly vague, subject to manipulation, or both. Mr. Rule raised an important and memorable point when he last testified before this Committee in 1997 during the important series of hearings convened by Senator Hatch on competition in the digital age. Testifying about the first Microsoft-Justice Department consent decree, Mr. Rule said: "Ambiguities in decrees are typically resolved against the Government. In addition, the Government's case must rise or fall on the language of the decree; the Government cannot fall back on some purported 'spirit' or 'purpose' of the decree to justify an interpretation that is not clearly supported by the language." We take seriously such counsel, and would worry if ambiguity in the proposed settlement would jeopardize its enforcement.

Second, I am concerned that the enforcement mechanism described in the proposed decree lacks the power and the timeliness necessary to inspire confidence in its effectiveness. Particularly in light of the absence of any requirement that the decree be read in broad remedial terms, it is especially important that we inquire into the likely operation of the proposed enforcement scheme and its effectiveness.

Any lawyer who has litigated cases and any business person knows how distracting litigation of this magnitude can be and appreciates the value that reaching an appropriate settlement can have not only for the parties but also for consumers, who are harmed by anticompetitive conduct, and the economy. I do not come to this hearing prejudging the merits of this proposed settlement but instead as one ready to embrace a good settlement that puts an end to the merry-go-round of Microsoft litigation over consent decrees. But the serious questions that have been raised about the scope, enforceability and effectiveness of this proposed settlement leave me concerned that, if approved in its current form, it may simply be an invitation for the next chapter of litigation. On this point, I share the concern of Judge Robert Bork, who warns, in his written submission, that the proposed settlement "contains so many ambiguities and loopholes as to make it unenforceable, and likely to guarantee years of additional litigation." I look forward to hearing from the Department of Justice and other distinguished witnesses today on the merits of this warning.

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**December 12, 2001 Contact: Margarita Tapia, 202/224-5225**

**STATEMENT OF SENATOR ORRIN G. HATCH  
RANKING REPUBLICAN MEMBER**

**Before the  
SENATE JUDICIARY COMMITTEE  
Hearing On**

**"The Microsoft Settlement: A Look to the Future"**

Mr. Chairman, as you know, we conducted a series of hearings in this Committee in 1997 and 1998 to examine the policy implications of the competitive landscape of the then burgeoning high-tech industry, which was about to explode with the advent of the Internet. Those hearings focused on competition in the industry, in general, and, more specifically, complaints that Microsoft had been engaged in anti-competitive behavior that threatened competition and innovation to the detriment of consumers. Our goal was, and I believe today is, to determine how best to preserve competition and foster innovation in the high-technology industry.

Although the Committee, and I, as its Chairman, was criticized by some, I strongly believed then, and continue to believe now, that in a robust economy involving new technologies, effective antitrust enforcement today would prevent the need for heavy-handed government regulation of business tomorrow. My interest in the competitive marketplace in the high-technology industry was animated by my strong opposition to regulation of the industry, whether by the government, or by one or few companies. As we may remember, the hearings before the Judiciary Committee developed an extensive record of Microsoft's conduct, and evidenced various efforts by the company to maintain and extend its operating system monopoly. Those findings, I would note, were reaffirmed by a unanimous, and ideologically diverse Court of Appeals. The Microsoft case - and its ultimate resolution - present one of the most important developments in antitrust law in recent memory.

As I have emphasized before, having a monopoly is not illegal under our laws. In fact, in a successful capitalist system, striving to be one should be encouraged. However, anticompetitive conduct intended to maintain or extend this monopoly would harm competition and could violate our laws. I believe no one would disagree that the D.C. Circuit's decision reaffirmed the fundamental principle that a monopolist - - even a monopolist in a high-tech industry like software - - must compete on the merits to maintain its monopoly.

Which brings us to today's hearing. We are here to examine the policy implications of the proposed settlement in the government's antitrust litigation against Microsoft.

Mr. Chairman, rather than closing the book on the Microsoft inquiry, the proposed settlement appears to be only the end of the latest chapter. The settling parties are currently in the middle of the so-called Tunney Act process before the court. And, the non-settling parties have chosen to further litigate this matter and last week filed their own proposed settlement. This has been a complex case with significant consequences for Microsoft, high-tech entrepreneurs and the American public. The proposed settlement between Microsoft and the Justice Department and nine of the plaintiff State attorneys general is highly technical. We have all been studying it, and its impact, with great interest. Each of us has heard from some, including some of our witnesses here today, that the agreement contains much that is very good. Not surprisingly, we have also heard and read much criticism of the settlement. These are complex

issues, and I would hope today's hearing will illuminate the many questions we have.

I should note that about two weeks ago, I sent a set of detailed and extensive questions about the scope, interpretation, and intended effects of the proposed settlement to the Justice Department, seeking further information. First, I want to commend the Department for getting the responses to me promptly. We received them yesterday. I think the questions, which were made public, and the Department's responses could be helpful to each member in forming an independent and fair analysis of the proposed settlement. To that end, and for the benefit of the Committee, Mr. Chairman, I would like to make both the questions and the Department's answers part of the record for this hearing, if you wouldn't have any objections.

As I noted in my November 29 letter to the Department, I have kept an open mind regarding this settlement, and continue to do so. I have had questions regarding the practical enforceability of the proposed settlement and whether it will effectively remedy the unlawful practices identified by the D.C. Circuit, and restore competition in the software market.

I am also cognizant of both the limitation of the claims contained in the original Justice Department complaint by the D.C. Circuit, as well as the standards for enforcement under settled antitrust law. I believe that further information regarding precisely how the proposed settlement will be interpreted, given D.C. Circuit case law, is necessary to any full and objective analysis of the remedies proposed therein. I hope that this hearing will result in the development of such information, that would supplement the questions I put forth to the Department.

Mr. Chairman, one important and critical policy issue that I would hope we can address today, and that I would like all of our witness to consider as they wait to be empaneled so that they can discuss, is the difficult issue of the temporal relation of antitrust enforcement in new high-technology markets. It cannot be overemphasized that timing is a critical issue in examining conduct in the so-called "new economy." Indeed, the most significant lesson the Microsoft case has taught us is this fact. The D.C. Circuit found this issue noteworthy enough to discuss in the first few pages of its opinion. And I will quote from the unanimous court:

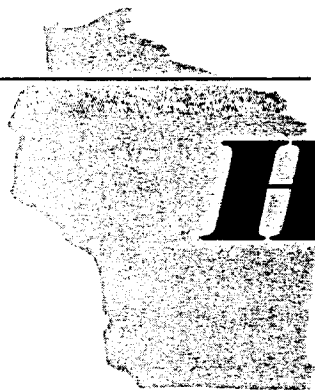
"[w]hat is somewhat problematic . . . is that just over six years have passed since Microsoft engaged in the first conduct plaintiffs allege to be anticompetitive. As the record in this case indicates, six years seems like an eternity in the computer industry. By the time a court can assess liability, firms, products, and the marketplace are likely to have changed dramatically. This, in turn, threatens enormous practical difficulties for courts considering the appropriate measure of relief in equitable enforcement actions . . . . [I]nnovation to a large degree has already rendered the anticompetitive conduct obsolete (although by no means harmless)."

This issue is one that is relevant for this Committee to consider as a larger policy matter, as well as how it relates to this case and the proposed settlement we are examining today.

Again, I want to thank you Mr. Chairman for continuing the Committee's important role in high-technology policy matters, and I look forward to hearing from our witnesses today.

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news from



# **HERB KOHL**

*United States Senator  
Democrat of Wisconsin*

330 Hart Senate Office Building • Washington, D.C. 20510 • (202) 224-5653

**FOR IMMEDIATE RELEASE:**

December 12, 2001

**Contact:** Lynn Becker or Jessica Catlin

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## **Statement of Senator Herb Kohl The Microsoft Settlement: A Look to the Future**

This is a pivotal time for competition in the high tech sector of our economy. After spending more than three years pursuing its groundbreaking antitrust case against Microsoft – a case that is likely to rewrite the rules for competition in the high tech industry for years to come – the government has announced a settlement. But the crucial question remains – will this settlement break Microsoft's stranglehold over the computer software industry and restore competition in this vital sector of the economy?

Frankly, I have serious doubts that it will.

An independent federal court – both the trial court and the Court of Appeals in fact – found that Microsoft broke the law and that its violations should be fixed. This antitrust case was as big as they come. Microsoft crushed a competitor, illegally tried to maintain its monopoly, and stifled innovation in this market. Now, after all these years of litigation, of charges and counter-charges, this settlement leaves us wondering – did we really accomplish anything? Or, in the words of the old song, is that all there is? Does this settlement obey the Supreme Court mandate that it must deny the antitrust violator “the fruits” of its illegal conduct?

It seems to many -- including nine of the states that joined the federal government in suing Microsoft -- that this settlement agreement simply is not strong enough to do the job – to restore competition to the computer software industry. It contains so many loopholes, qualifications and exceptions that many worry that Microsoft will be easily able to evade its provisions. Let me give just one example – the requirement that Microsoft must allow computer users to install competing software products only applies with respect to software that has had one million copies distributed in the last year. New software competitors just are not protected by this provision.

Today, for the vast majority of computer users, the first thing they see when they turn on their machine is the now familiar Microsoft logo, placed on the Microsoft start menu. And all of their computer operations take place through the filter of Microsoft's Windows operating system. Microsoft's control over the market is so strong that today more than 95% of all personal computers

**-more-**

run on the Windows operating system, a market share high enough to constitute a monopoly under antitrust law. Its share of the Internet browsing market is now over 85%. It reported a profit margin of 25% in the most recent quarter, a very high rate of return in challenging economic times. Microsoft has the power to dictate terms to manufacturers who wish to gain access to the Windows operating system and the ability to leverage its dominance into other forms of computer software. And Microsoft has never been shy about using its market power. Are we really confident that, in five years, this settlement will have had any appreciable impact on these facts of life in the computer industry?

We today stand on the threshold of writing the rules for competition in the digital age. We've got two options. One option involves one dominant company controlling the computer desktop, facing minor restraints that expire in five years, but acting as a gatekeeper to 95% of all personal computer users. The other model is the flowering of innovation and new products that resulted from the break-up of the AT&T telephone monopoly nearly twenty years ago. From cell phones to faxes, from long distance price wars to the development of the Internet itself, the end of the telephone monopoly brought an explosion of new technologies and services that benefit millions of consumers every day. We should insist on nothing less in this case.

In sum, any settlement in this case should make the market for computer software at least as competitive as the market for computer hardware is today. While there's nothing wrong with settling, we should insist on a settlement that has an immediate, substantial, and permanent impact on restoring competition in this industry.

# # #

**OPENING REMARKS OF SENATOR RICHARD J. DURBIN**

**Hearing Before the**

**Senate Committee on the Judiciary**

**on**

**“The Microsoft Settlement: A Look to the Future”**

**December 12, 2001**

Ever since the Department of Justice and Microsoft announced, in early November, their plan to settle the long-running antitrust litigation, a lot of people have weighed in with their concerns.

This hearing is important because it provides those of us in Congress with the first real opportunity to examine the terms of the proposed Microsoft settlement, and to hear from all sides of this issue. I think it is important that everyone understands what this settlement means, both in terms of the specific details, and in the longer term ramifications, before they level any criticism.

It's also important to note that the proceeding is still ongoing, and that this matter is still before the judge in a “Tunney Act proceeding.” So, I hope today's hearing will shed valuable light on what this settlement means for all of us in an objective and educational way.

Like me, most of our constituents have owned and used personal computers for a long time, and most who do own computers utilize Microsoft Windows PC operating systems. So we are very familiar with and have gotten quite used to Microsoft products and services. And it is our constituents who will bear the long-term impact of this settlement, whatever results that will mean in the market. I hope we keep that in mind as we scrutinize the terms agreed upon between the Justice Department, state attorneys general and Microsoft.

I think one of the difficulties that this settlement attempted to resolve is to try to address problems that arose in the past while, at the same time, anticipate and regulate potential anti-competitive conduct in the future.

In a technology industry that is innovative and constantly evolving, this is obviously a challenge, and I'm sure there are issues that the settlement could not or did not anticipate. At this hearing, I'd like to learn what some of these missing issues are.

Another issue of interest to me involves the Internet market. With the launch of Windows XP – Microsoft's newest operating system – the issues raised by the original Justice Department complaint remain salient in determining the scope of the marketplace for web-based services.

Some opponents of Microsoft throughout the litigation, and even now with this settlement, have contended that Microsoft intends to leverage its dominance in the PC marketplace to establish itself as *the* player in web-based services. It is unclear to me just how much of those concerns will be resolved by this settlement, so I look forward to hearing Microsoft's response.

Finally, I am interested in knowing more about the innovative enforcement mechanism included in the settlement decree. I understand that this is probably the most stringent enforcement requirement ever imposed by the Justice Department in an antitrust matter. But I don't know how workable it will be for the Justice Department to remain so intimately involved over the next five years given how fast the technology industry changes. Five years is an eternity in the high-tech world. In negotiating this settlement, I hope that the Department relied on the many lessons it learned from its experience with the AT&T breakup and the long-term monitoring that that case involved.

Ultimately, we must find a way to promote competition and choice in the technology marketplace while continuing to encourage investment and innovation by this dynamic industry. Reasonable people can disagree about how we ought to get there.

I am grateful that today's hearing presents us with an opportunity to hear from knowledgeable witnesses on both sides of this dispute.

Thank you.



**STATEMENT OF SENATOR JEFF SESSIONS  
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY  
“THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE”  
December 12, 2001**

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I am troubled by the decision of Committee, acting in its official capacity, to send a transcript of this hearing to the federal district court that will determine the outcome of this pending litigation. By taking the apparently unprecedented step of sending a transcript of a hearing on pending litigation to the judge that is deciding the case, this Committee may have unintentionally traversed the critical boundary between attempting to inform the court and attempting to influence it.

The Constitution vests the legislative power in the Congress, Article I, § 1, the executive power in the President, Article II, § 1, and the judicial power in the Supreme Court and lower federal courts, Article III, § 1. Thus, Congress has the power to make law pursuant to its enumerated powers, the President has the power to enforce these laws, and the courts have the separate power to “say what the law is” – “to rule on cases ... to decide them,” Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803); Plaut v. Spendthrift Farm, Inc., 514 U.S. 211, 218 (1995).

The separation of powers principle not only outlines the distinct spheres of operation of the three branches of government but also guides the branches in their dealings with each other. It is crystal clear that the Framers

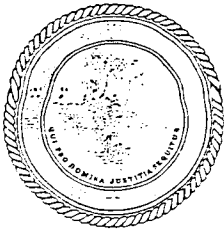
of our Constitution intended to have a judiciary that is independent of Congress. The provision for judges to hold office during good behavior in Article III, § 1, for example, was said by Alexander Hamilton to constitute an “excellent barrier to the encroachments and oppressions of the representative body.” THE FEDERALIST NO. 78, at 465 (Hamilton) (Clinton Rossiter ed., 1961). Thus, with respect to this case, Congress, the Senate, and this Committee, should defer to the court to decide the case by exercising its independent judgement. A publicized congressional hearing and a transcript submission to the court can only be perceived as an attempt to create for senators a status at a Tunney hearing that neither the court nor the Tunney Act permits.

While the Tunney Act provides that a district court should accept comments from the public on a proposed antitrust settlement agreement, it does not provide for any role by the legislative branch in such a hearing. See Pub. L. No. 93-528 (1974). Indeed, the Congressional Research Service has informed me that it has found “no instances in which any comments – whether Hearing transcripts, summaries of Hearing transcripts, or other written communications – were sent to” the district court in a Tunney Act hearing. Congressional Research Service, Memorandum 2 (Dec.18, 2001).

While any senator may file comments on a proposed settlement agreement as a private citizen, it infringes upon the separation of powers

principle for the Senate or this Committee officially to do so. It is the litigants and the public that inform the court in a Tunney Act hearing, not the Congress. See Pub. L. No. 93-528. For this Committee to submit its views on the merits of pending litigation creates the appearance of an attempt to influence the Article III federal court in the exercise of its independent judicial power.

In addition to my constitutional concern, I have an underlying prudential concern. This transcript will include several statements from Senators opining on the merits of the Microsoft settlement agreement. A case such as this one involves a complex body of law and an extraordinary amount of evidence. Neither I nor, to the best of my knowledge, any other member of this Committee or of the Senate has had an opportunity to thoroughly review the law and the facts of this case. Consequently, our opinion with respect to this non-legislative matter is worth no more than that of any other reasonably informed citizen who may submit information to the court. There is no legitimate rationale for any court to give more weight to our opinions, whether stamped with the imprimatur of this Committee or not, than to the opinions of others. Accordingly, I respectfully object to the Chairman and Ranking Member's decision, without a vote of the Committee, to submit on behalf of the Committee, a copy of the transcript of this hearing to the district court.



# Department of Justice

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STATEMENT

OF

CHARLES A. JAMES  
ASSISTANT ATTORNEY GENERAL  
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE

CONCERNING

THE MICROSOFT SETTLEMENT:  
A LOOK TO THE FUTURE

PRESENTED ON

DECEMBER 12, 2001

Mr. Chairman and members of the Subcommittee, I am pleased to appear before you today to discuss the Department's still-pending antitrust enforcement action against Microsoft Corporation.

On November 2, 2001, the Department stipulated to entry of a proposed consent decree that would resolve the case. Nine states joined in the proposed settlement.<sup>1</sup> We are in the midst of the 60-day public comment period under the Tunney Act, after which we will file a response to the comments, and the district court will rule on whether the proposed consent decree is in the public interest. Nine other states, and the District of Columbia, have not signed the proposed consent decree.

The Department's position regarding the proposed settlement is set forth in documents filed in the pending Tunney Act proceeding. Because of the pendency of the proceeding, and the somewhat remote possibility that the case will return to litigation, I am somewhat limited in what I can say about the case and settlement. Nonetheless, I am happy to appear before you today to discuss in general terms how the settlement promotes the public interest by resolving the allegations sustained by the court of appeals.

When we in the Department address the Microsoft case, it is important for us

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<sup>1</sup> New York, Ohio, Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina, and Wisconsin

to ignore the media spectacle and clash-of-the-titans imagery and focus instead on the actual legal dispute presented to the court. In discussing the case and the proposed consent decree, it is important to keep in mind not only what the Department alleged in our complaint, but how the courts -- in particular, the D.C. Circuit -- ruled. As a result of the appeals court's ruling, the case is in many important respects considerably narrower than the one the Department originally brought in the spring of 1998 and narrower still than Judge Jackson's ruling in June of 2000.

I would like to take a few minutes to refocus attention on the legal allegations charged in the complaint, how those allegations were resolved in the courts, and the remedies in the proposed consent decree presently undergoing Tunney Act review. I believe these proposed remedies fully and demonstrably resolve the monopoly maintenance finding that the D.C. Circuit affirmed.

The complaints filed by the Department, the states, and the District of Columbia alleged: (1) that Microsoft had engaged in a series of specific anticompetitive acts, and a course of anticompetitive conduct, to maintain its monopoly position in the market for operating systems designed to run on Intel-compatible personal computers, in violation of Section 2 of the Sherman Act; (2) that Microsoft had attempted to monopolize the web browser market, also in

violation of Section 2; (3) that Microsoft had illegally tied its web browser, Internet Explorer, to its operating system, in violation of Section 1; and (4) that Microsoft had entered into exclusive dealing arrangements that also violated Section 1. A separate monopoly leveraging claim advanced by the state plaintiffs was dismissed prior to trial. After a full trial on the merits, the district court ultimately sustained the first three claims, while finding that the exclusive dealing claim had not been proved.

The D.C. Circuit, however, significantly narrowed the case, affirming the district court's finding of liability only as to the monopoly maintenance claim, and even there only as to a smaller number of specified anticompetitive actions. Of the twenty anticompetitive acts the court of appeals reviewed, it reversed with respect to eight of the acts that the district court had sustained as elements of the monopoly maintenance claim. Additionally, the D.C. Circuit reversed the lower court's finding that Microsoft's "course of conduct" separately violated Section 2 of the Sherman Act. It reversed the district court's rulings on the attempted monopolization and tying claims, remanding the tying claim for further proceedings under a much more difficult rule of reason standard. And, of course, it vacated the district court's final judgment that had set forth the break-up remedy and interim conduct remedies.

The antitrust laws do not prohibit a firm from having a monopoly, but only from illegally acquiring or maintaining a monopoly through interference with the competitive efforts of rivals. There has never been any serious contention that Microsoft *acquired* its operating system monopoly through unlawful means, and the existence of the operating system monopoly itself was not challenged in this case.

With regard to the monopoly maintenance claim, the court of appeals upheld the conclusion that Microsoft had engaged in unlawful exclusionary conduct by using contractual provisions to prohibit computer manufacturers from supporting competing middleware products on Microsoft's operating system; by prohibiting consumers and computer manufacturers from removing Microsoft's middleware products from the desktop; and by reaching agreements with software developers and third parties to exclude or disadvantage competing middleware products -- all to protect Microsoft's monopoly in the operating system market.

The Department proved that Microsoft had engaged in these anticompetitive practices to discourage the development and deployment of rival web browsers and Java technologies, in an effort to prevent them from becoming middleware threats to its operating system monopoly. Netscape had gained a respectable market share as a technology for navigating the then-burgeoning Internet, and



Netscape proponents were touting the prospect of a new world of Internet computing that would make operating systems less relevant. Netscape touted its web browser as a new category of software that came to be known as “middleware,” a form of software that, like Microsoft’s Windows operating system, exposed a broad range of applications program interfaces (“APIs”) to which software developers could write applications. This created the potential that -- if Netscape Navigator continued to gain market share and could run on operating systems other than Microsoft’s, *and* if large numbers of software developers wrote applications programs to it -- computer users would have viable competitive alternatives to Microsoft.

The middleware threat was nascent. That is, as both the district court and the court of appeals acknowledged, it was a potential threat to the operating system monopoly that had not yet become real. It could not be predicted when, if ever, enough applications programs would be written to middleware products for middleware to significantly displace Microsoft operating systems. Microsoft took this nascent middleware threat to its operating system monopoly seriously. The trial record disclosed a corporate preoccupation with thwarting Netscape and displacing Netscape’s Navigator with Microsoft’s Internet Explorer as the prevailing web browser. This campaign featured a host of strong-arm tactics aimed

at various computer manufacturers, Internet access providers, and independent software developers. Even the decision to integrate its own browser into the operating system -- in effect, giving it away for free -- had an element of impeding the growth of Netscape and once was described as taking away Netscape's oxygen. Microsoft took similar actions against Java technologies. Among other things, Microsoft required software developers to promote its own version of Java technology exclusively and threatened developers if they assisted competing Java products.

The district court ruled not only that Microsoft had engaged in various specified illegal exclusionary practices, but that these acts were part of an overall anticompetitive course of conduct. The D.C. Circuit agreed as to some of the specified practices, while ruling that others -- for example, Microsoft's practice of preventing computer manufacturers from substituting their own user interfaces over the Windows interface supplied by Microsoft -- were justified and thus lawful. The D.C. Circuit also rejected the course-of-conduct theory, under which Microsoft's specific practices could be viewed as parts of a broader, more general monopolistic scheme, ruling that Microsoft's practices must be viewed individually.

Following the appellate court's instructions, we, in considering a possible remedy, focused on the specific practices that the court had ruled unlawful. We

took as a starting point the district court's interim conduct remedies. Those remedies, however, were based on a much wider range of liability findings than had been affirmed on appeal. Accordingly, they had to be tailored to the findings that had actually been affirmed. Further, because the interim conduct remedies were designed to apply only as a stop-gap until the district court's divestiture order was implemented, we broadened them in important respects to more fully address the remedial objectives of arresting the anticompetitive conduct, preventing its recurrence, and restoring lost competition to the marketplace. Finally, we updated the remedies to strengthen their long-term effectiveness in the face of the rapid technological innovation that continues to characterize the computer industry -- so that they will be relevant in the Windows XP operating system world and beyond.

Under the proposed consent decree, Microsoft will be required to disclose to other software developers the interfaces used by Microsoft's middleware to interoperate with the operating system, enabling other software developers to create competing products that emulate Microsoft's integrated functions. Microsoft will also have to disclose the protocols that are necessary for software located in a server computer to interoperate with Windows on a PC.

Microsoft will have to permit computer manufacturers and consumers to substitute competing middleware software on the desktop. It will be prohibited

from retaliating against computer manufacturers or software developers for supporting or developing certain competing software. To further guard against possible retaliation, Microsoft will be required to license its operating system to key computer manufacturers on uniform terms for five years.

Microsoft will be prohibited from entering into agreements requiring the exclusive support or development of certain Microsoft software, so that software developers and computer manufacturers can continue to do business with Microsoft while also supporting and developing rival middleware products. And Microsoft will be required to license any intellectual property to computer manufacturers and software developers necessary for them to exercise their rights under the proposed decree, including, for example, using the middleware protocols disclosed by Microsoft to interoperate with the operating system.

Any assumption that, had we litigated the remedy, we were certain to have secured all of this relief and possibly more misses the mark. The middleware definition, for example, was a very complex issue and would have been hard fought in a litigated remedy proceeding. The term had no generally accepted industry or technical meaning. At the time of trial, the term was used to describe software programs that exposed APIs. But in today's world, by virtue of the extensive degree to which software programs interact with each other, a very broad range of

programs -- large and small, simple and complex -- expose APIs. At the same time, middleware had to be defined more broadly than the browser, or it would not provide sufficient protection for the potential sources of competition that might emerge. So we developed a definition of middleware, designed to encompass all technologies that have the potential to be middleware threats to Microsoft's operating system monopoly. It captures, in today's market, Internet browsers, e-mail client software, networked audio/video client software, and instant messaging software. On a going-forward basis, it also provides guidelines for what types of software will be considered middleware for purposes of the decree in the future. These guidelines are critical because, while it is important that future middleware products be captured by the proposed decree, those products will not necessarily be readily identified as such.

The proposed decree protects competition in the middleware market through a variety of affirmative duties and prohibitions, which I listed a minute ago. By requiring disclosure of a broad range of interfaces and protocols that will secure interoperability for rival software and servers, broadly banning exclusive dealing, giving computer manufacturers and consumers extensive control of the desktop and initial boot sequence, and prohibiting a broad range of retaliatory conduct, the proposed decree will require Microsoft to fundamentally change the way in which it

deals with computer manufacturers, Internet access providers, software developers, and others.

These prohibitions had to be devised keeping in mind that Microsoft will continue for the foreseeable future to have a monopoly in the operating systems market. While we recognized that not all forms of collaboration between Microsoft and others in the industry are anticompetitive, and that some actually benefit competition, we drafted the non-discrimination and non-retaliation provisions broadly enough to prevent Microsoft from using its monopoly power to apply anticompetitive pressure in this fashion.

We concluded, particularly in light of intervening technological developments in the computer industry, that the remedial objective of restoring lost competition had to mean something different than attempting to restore Netscape and Java specifically to their previous status as potential nascent threats to Microsoft's monopoly. Attempting to turn back the hands of time would likely prove futile and would risk sacrificing important innovations that have moved the industry beyond that point. So we focused instead on the market as it exists today, and where it appears to be heading over the next few years, and devised a remedy to recreate the potential for the emergence of competitive alternatives to Microsoft's operating system monopoly through middleware innovations. With a reported 70,000-odd

applications currently designed to run on Windows, the applications barrier to entry is quite formidable. The most effective avenue for restoring the competitive potential of middleware, we concluded, was to ensure that middleware developers had access to the technical information necessary to create middleware programs that could compete with Microsoft in a meaningful way -- that is, by requiring Microsoft to disclose the APIs needed to enable competing middleware developers to create middleware that matches Microsoft's in efficiency and functionality.

API disclosure had apparently been a very difficult obstacle to resolution of the case at every stage. There had never been any allegation in the case that Windows was an essential facility, the proprietary technology for which had to be openly shared in the industry. So we are very pleased that we were able to secure this crucial provision in the proposed decree.

Similarly, the proposed decree goes beyond the district court's order in requiring Microsoft to disclose communications protocols for servers if they are embedded in the operating system, thereby protecting the potential for server-based applications to emerge as a competitive alternative to Microsoft's operating systems monopoly. Although the issue of Microsoft's potential use of its monopoly power to inhibit server-based competition was barely raised and never litigated in the district court, we believed it was an important concern to resolve in

the final negotiations.

The proposed decree also requires Microsoft to create and preserve “default” settings, such that certain of Microsoft’s integrated middleware functions will not be able to override the selection of a third-party middleware product, and requires Microsoft to create add/delete functionality to make it easier for computer manufacturers and users to replace Microsoft middleware functionality with independently developed middleware. These are other important respects in which, in light of intervening technological changes, the proposed decree goes beyond the relief contemplated in the district court’s interim relief order. By giving middleware developers the means of creating fully competitive products, requiring the creation of add/delete functionality, and making it absolutely clear that computer manufacturers can, in fact, replace Microsoft middleware on the desktop, the decree will do as much as possible to restore the nascent threat to the operating system monopoly that browsers once represented.

The proposed decree contains some of the most stringent enforcement provisions ever contained in any modern consent decree. In addition to the ordinary prosecutorial access powers, backed up by civil and criminal contempt authority, this decree has two other aggressive features. First, it requires a full-time, on-site compliance team -- complete with its own staff and the power to hire



consultants -- that will monitor compliance with the decree, report violations to the Department, and attempt to resolve technical disputes under the disclosure provisions. The compliance team will have complete access to Microsoft's source code, records, facilities, and personnel. Its dispute resolution responsibilities reflect the recognition that the market will benefit from rapid, consensual resolution of issues whenever possible, more so than litigation under the Department's contempt powers. The dispute resolution process complements, but does not supplant, ordinary methods of enforcement. Complainants may bring their inquiries directly to the Department if they choose.

The decree will be in effect for five years. It also contains a provision under which the term may be extended by up to two additional years in the event that the court finds that Microsoft has engaged in repeated violations. Assuming that Microsoft will want to get out from under the decree's affirmative obligations and restrictions as soon as possible, the prospect that it might face an extension of the decree should provide an extra incentive to comply.

Our practice with regard to enforcement is never influenced by the extent to which we "trust" a defendant. Rather, a decree must stand on its own as an enforcement vehicle to ensure effective relief and must contain enforcement provisions sufficient to address its inherent compliance issues. In this case, those

compliance issues are complex, as the decree seeks to address Microsoft's interactions with firms throughout the computer industry. Under the circumstances, I believe the extraordinary nature of the decree is warranted.

Some have criticized the decree for not going far enough. Some have asked why we did not continue to pursue divestiture as a possible remedy. We had several reasons. First, the court of appeals made it clear that it viewed the break-up remedy with skepticism, to put it mildly. The court ruled that on remand the district court must consider whether Microsoft is a unitary company -- i.e., one that could not easily be broken up -- and whether plaintiffs established a significant causal connection between Microsoft's anticompetitive conduct and its dominant position in the market for operating systems -- a finding not reached by the prior judge.

Second, the legal basis for the structural separation the Department had been seeking was undercut by the failure to sustain the two claims that had challenged Microsoft's right to compete outside its operating system monopoly by integrating new functions into Windows, the attempted monopolization claim and the tying claim. The former was dismissed, and the latter was remanded under a much more difficult rule-of-reason standard. The court of appeals ruled that, albeit with some limits, Microsoft could lawfully integrate new functions into the operating system and use the advantages flowing from its knowledge and design of the operating

system to compete in downstream markets.

Third, and more generally, the relief in a section 2 case must have its foundation in the offending conduct. The monopoly maintenance finding, as modified by the court of appeals, and without the "course-of-conduct" theory, would not in our view sustain a broad-ranging structural remedy that went beyond what was necessary to address Microsoft's unlawful responses to the middleware threat to its operating system monopoly. Indeed, our new district judge, Judge Kollar-Kotelly, stated in open court that she expected our proposed remedy to reflect the fact that portions of our case had not been sustained.

Finally, from a practical standpoint, even assuming that we could have eventually secured a breakup of Microsoft -- a very dubious assumption in light of what the court of appeals and Judge Kollar-Kotelly have stated -- the time it would have taken to continue litigating the break-up and the inevitable appeals could easily have delayed relief for another several years. By taking structural relief off of the table at the outset of the remedy proceeding on remand, we were able to get favorable procedural rulings that were essential to moving quickly to a prompt resolution.

More generally, a number of critics have suggested ways in which we could have further constrained Microsoft's conduct in the marketplace -- either by

excluding it from markets outside the operating system market, restricting it from integrating functions into its products or collaborating with others, or requiring it to widely share its source code as an open platform. While it is certainly true that restrictions and requirements of this sort might be desirable and advantageous to Microsoft's competitors, they would not necessarily be in the interest of competition and consumers overall; many would reduce consumer choice rather than increase it. Moreover, to the extent these restrictions go beyond what is needed to remedy proven antitrust violations, they are not legitimate remedial goals. The objectives of civil antitrust enforcement are remedial, and they focus on protecting and restoring competition for the benefit of consumers, not on favoring particular competitors.

As to more complex questions regarding whether the decree has properly covered all the elements that will be needed for full relief, questions of that nature are entirely appropriate and hopefully will be raised and addressed in the Tunney Act process.

But I believe the decree, by creating the opportunity for independent software vendors to develop competitive middleware products on a function-by-function basis, by giving computer manufacturers the flexibility to place competing middleware products on Microsoft's operating system, and by

preventing retaliation by Microsoft against those who choose to develop or use competing middleware products, fully addresses the legitimate public goals of stopping Microsoft's unlawful conduct and restoring competition lost on its account.

Mr. Chairman, a vigorously competitive computer software industry is vital to our economy, and the Department is committed to ensuring that it remains competitive. I hope that my testimony has helped members of the Committee more fully understand why the Department is completely satisfied that the proposed consent decree now before the district court will provide a sufficient and effective remedy for the anticompetitive conduct in which Microsoft has been found to have engaged in violation of the Sherman Act. I would be happy to answer any questions you or other members of the Committee may have.



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**SENATE COMMITTEE ON THE JUDICIARY**

**HEARING ON**

**THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE**

**TESTIMONY OF JAY L. HIMES,**

**CHIEF, ANTITRUST BUREAU**

**OF THE**

**NEW YORK STATE ATTORNEY GENERAL'S OFFICE**

Washington, D.C.  
Wednesday, December 12, 2001

Chairman Leahy and distinguished Members of this Committee, thank you for inviting me to testify before you today on the important issues relating to the settlement of the case against Microsoft, brought by the Antitrust Division of the United States Department of Justice, 18 States and the District of Columbia. New York is one of the lead States in this lawsuit, and we have had a central role in the matter going back to the investigation that led to the filing of the case.

As the members of the Committee know, on Friday, November 2, 2001, the DOJ and Microsoft reached a proposed settlement of the lawsuit, which was then publicly announced. After further negotiations between Microsoft and the States, a revised settlement was reached on Tuesday, November 6, 2001. New York — together with the States of Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina, Ohio and Wisconsin — agreed to the revised settlement. The remaining State plaintiffs — California, Connecticut, Florida, Iowa, Kansas, Massachusetts, Minnesota, Utah, West Virginia and the District of Columbia — are seeking a judicially ordered remedy, as is their right.

I, together with an Assistant Attorney General from the State of Ohio, were the principal representatives of the States in the lengthy negotiations that led to the proposed final judgment embodying the settlement. Therefore, I believe that we in New York see the Microsoft settlement from a vantage point that others who were not

in the negotiating room may lack. I will do my best to try to share our observations with the Committee. I will begin by presenting an overview of the lawsuit and the settlement reached. After that, I will address in more detail several of the central features of the settlement. Then, I wish to turn to the settlement process itself, particularly insofar as it bears on criticism of the proposed final judgment.

### **1. Overview of the Case and the Settlement**

In May 1998, New York, 18 other States and the District of Columbia began a lawsuit against Microsoft, alleging violations of federal and state antitrust laws.<sup>1</sup> The States' case was similar to an antitrust case commenced that same day by DOJ, and the two cases proceeded on a consolidated basis. In summary, the litigation against Microsoft charged that the company unlawfully restrained trade and denied consumers choice by: (1) monopolizing the market for personal computer ("PC") operating systems; (2) bundling (or "tying") Internet Explorer — Microsoft's web browser — into the Windows operating system used on most PCs; (3) entering into arrangements with various industry members that excluded competitive software; and (4) attempting to monopolize the market for web browsers.

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<sup>1</sup>Subsequently, one State (South Carolina) dropped out, and another (New Mexico) settled earlier this year.



After a lengthy trial, the District Court upheld the governments' claims that Microsoft had unlawfully: (1) maintained a monopoly in the PC operating system market; (2) tied Internet Explorer to its Windows operating system monopoly; and (3) attempted to monopolize the browser market. The District Court issued a final judgment breaking up Microsoft into two separate businesses, and ordering certain conduct remedies intended to govern Microsoft's business activities pending completion of the break-up. These remedies were stayed while Microsoft appealed.

In June of this year, the Court of Appeals for the District of Columbia Circuit issued its decision on appeal. *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001). The Court of Appeals broadly upheld the lower court's monopolization maintenance ruling, although it rejected a few of the acts of monopolization found by the District Court including the Court's determination that Microsoft's overall course of conduct itself amounted to monopoly maintenance. On the tying claim, the Court of Appeals reversed the lower court's holding of an antitrust violation, and ordered a new trial under the rule of reason — a standard more favorable to Microsoft than the standard previously used by the trial court. In view of these rulings, the Circuit Court vacated the final judgment, including the break-up provisions. Finally, the Court of Appeals disqualified the trial judge from hearing further proceedings. Thereafter, the Court of Appeals denied a rehearing petition by Microsoft, and the

Supreme Court declined to hear an appeal by Microsoft concerning the Court of Appeals' disqualification ruling.

The Court of Appeals returned the case to the District Court in late August of this year. At that point, a new judge — Hon. Colleen Kollar-Kotelly — was assigned. Shortly after that, DOJ and the States announced their intention, in the forthcoming proceedings before the District Court, to refrain from seeking another break up order — and to focus instead on conduct remedies modeled on those included in the earlier District Court judgment. DOJ and the States also announced that they would not retry the tying claim under the rule of reason test that the Court of Appeals had adopted. These decisions by the government enforcers were made in an effort to jump-start the process of promptly obtaining a strong and effective remedy for Microsoft's anticompetitive conduct, as upheld by the Court of Appeals' decision.

The parties appeared before Judge Kollar-Kotelly for the first time at a conference held on September 28, 2001. The Court directed the parties to begin a settlement negotiation and mediation process, which would end on November 2. Specifically, the Court noted that "I expect [the parties] to engage in settlement discussions seven days a week around the clock in order to see if they can resolve this case." (Transcript of September 28, 2001 proceedings, page 5) The Court also adopted a detailed schedule governing the proceedings leading to a hearing on

remedies, which the Court tentatively set for March 2002, if no settlement could be reached.

The settlement process that the District Court thus set in motion resulted in a proposed final judgment agreed to by Microsoft, DOJ and nine of the plaintiff States. The overarching objective of this settlement is to increase the choices available to consumers (including business users) who seek to buy PCs by promoting competition in the computer and computer software industries. More specifically (and as I will explain further below), the proposed final judgment includes the following means to increase consumer choice and industry competition:

- Microsoft will be prohibited from using various forms of conduct to punish or discourage industry participants from developing and offering products that compete or could compete with the Windows operating system, or with Microsoft software running on Windows.
- Microsoft will be prohibited from restricting the ability of computer manufacturers to make significant changes to Windows, thereby encouraging manufacturers to offer consumers more choice in the features included in PCs available for purchase.
- Microsoft will be required to disclose significant technical information that will help industry participants to develop and offer products that work well with Windows, and, in this way, potentially aid in the development of products that will compete with Windows itself.
- Microsoft will be subject to on-site scrutiny by a specially selected three-person committee, charged with responsibility to assist in

enforcing Microsoft's obligations under the settlement, and to help resolve complaints and inquiries that arise by virtue of the settlement.

New York decided to settle the Microsoft case because we believe that the deal hammered out over the many weeks of negotiations will generate a more competitive marketplace for consumers and businesses throughout the country, and, indeed, throughout the world. In summary, the settlement that the parties have submitted to the District Court for approval will accomplish the following:

## **2. Empowering Computer Manufacturers to Offer Choices to Consumers**

First, the proposed final judgment will empower computer manufacturers — the “OEMs” — to offer products that give consumers choice. Under the settlement, OEMs have the opportunity to add competing middleware to the Windows operating system in place of middleware included by Microsoft. (Section III, paragraphs C and H)<sup>2</sup> Middleware here refers not only to software like the Netscape browser, one of the subjects of the liability trial, but also to other important PC functions, such as email, instant messaging, or the media players that enable consumers to receive audio

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<sup>2</sup> Parenthetical references are to Revised Proposed Final Judgment attached to the Stipulation, dated November 6, 2001 (the “November 6 Stipulation”), in *United States v. Microsoft Corp.*, Civil Action No. 98-1232 (CKK)(D.D.C.), and *State of New York v. Microsoft Corp.*, Civil Action No. 98-1233 (CKK)(D.D.C.) (together “Microsoft”).

and visual content from the Internet. (Section VI, paragraphs K and M)<sup>3</sup> Middleware is important, in the context of this case, because it may help break down barriers that protect Microsoft's Windows monopoly.

The government negotiators insisted on, and eventually obtained, a broad definition of middleware so that the proposed decree covers both existing middleware and middleware not currently in existence, but which Microsoft and its competitors may develop during the term of the decree. The reason for our pressing a broad definition is plain enough: the broader the definition of middleware, the more software covered by the settlement, and the greater the opportunity for a software product to develop in a fashion that challenges the Windows monopoly.

Under the proposed decree, OEMs will have the ability to customize the PC's that they offer. They may, for example, add icons launching both competing middleware — and products that use competing middleware — to the Windows desktop or Start menu, and to other places in the Windows operating system. OEMs also will have the ability to suppress the existence of the competing middleware that Microsoft included in the Windows operating system licensed to the OEM. Microsoft

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<sup>3</sup> For ease of exposition, I refer in this testimony to "middleware" as a generic term. In the proposed final judgment itself, there are four related middleware definitions, which are associated with various substantive provisions in the decree. (See Section VI, paragraphs J, K, M, N; Section IV(A) of the Competitive Impact Statement, dated November 15, 2001, filed in *Microsoft*.)

itself will have to redesign Windows to the extent needed to permit this sort of substitution of middleware, and to ensure that the OEMs' customization of Windows is honored. (Section III, paragraphs C and H)<sup>4</sup>

The options available to OEMs under the settlement mean that the Windows desktop is up for sale. Companies offering a package of features that includes middleware, and middleware developers themselves, who desire to put their product into the hands of consumers can go to OEMs and buy a part of the real estate that the Windows desk top represents. This opportunity for additional revenue should further empower OEMs to develop competing computer products that offer choice to consumers.

The OEMs' ability to offer consumers competing middleware is backed up by a broad provision that prohibits Microsoft from "retaliating" against OEMs for any decision to install competing middleware (as well as any operating system that competes with Windows). (Section III, paragraph A) This provision forbids Microsoft from altering any of its commercial relations with an OEM, or from denying an OEM a wide array of product support or promotional benefits, based on the OEM's efforts to offer competitive alternatives. (Section VI, paragraph C)

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<sup>4</sup> PC users themselves will have a similar ability to customize Windows.

Then, to back up the non-retaliation provision, Microsoft also is required to license Windows to its 20 largest OEMs (who comprise roughly 70% of new PC sales) under uniform, non-discriminatory terms. (Section III, paragraph B) Microsoft also is prohibited from terminating any of its 20 largest OEMs for Windows licensing violations without first giving the OEM notice and an opportunity to cure the alleged violation. (Section III, paragraph A)

### **3. Empowering Software Developers and Others to Offer Competing**

#### **Middleware**

Second, the proposed final judgment seeks to encourage independent software developers — referred to as “ISVs” — to write competing middleware. This is accomplished by forbidding Microsoft from retaliating against any ISV based on the ISV’s efforts to introduce competing middleware or a competing operating system into the market. (Section III, paragraph F) The literally thousands of ISVs in the industry are protected by this additional non-retaliation provision, and they are protected whether or not they have an on-going business relationship with Microsoft.

ISVs, and many other industry participants, are further protected by provisions that prohibit Microsoft from entering into exclusive dealing arrangements relating to middleware or operating systems. Exclusive dealing arrangements are a device that Microsoft used to deny competitors access to the distribution lines needed to enable

their products to gain acceptance in the marketplace. (Section III, paragraphs F, G)

We have effectively closed off that practice to Microsoft.

#### **4. Requiring Microsoft to Disclose Information to Facilitate Interoperation**

Third, the proposed final judgment requires Microsoft to provide the technical information — “interfaces” and “protocols” — that industry members need to enable competing middleware to work well with Windows. Middleware uses functions of the Windows operating system through connections or “hooks” called “applications programming interfaces” — “APIs” for short. Microsoft will now be required to disclose the APIs that its own middleware uses to interoperate with Windows, and to provide technical documents relating to those APIs, so that ISVs who wish to develop competing middleware will have the information needed to make their products work well with Windows. (Section III, paragraph D)

This is, again, a place where the broad definition of middleware, covering both existing and yet to be developed products, matters. (Section VI, paragraph J) The broader the definition, the greater the number of APIs that Microsoft must disclose and document. The greater the technical information made available, the greater the



likelihood that industry participants will be able to develop competing middleware that works well on Windows.<sup>5</sup>

The proposed decree goes beyond requiring disclosure of APIs between Windows and Microsoft middleware. More and more, at-home consumers and computer users in the workplace can obtain functionality that they need from either the Internet or from network servers operating in a business setting. This trend means that computer applications running on servers may be an emerging location for developing middleware that could challenge the Windows monopoly at the PC level. Thus, the settlement is designed to prevent Microsoft from using Windows to gain competitive advantages in the way that PCs talk to servers. This is accomplished by requiring Microsoft to disclose, via a licensing mechanism, what are called “protocols” used to enable PCs and servers to communicate with each other. (Section III, paragraph E)

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<sup>5</sup> Strictly speaking, if Microsoft refrains from separately distributing a particular middleware product included in Windows, it need not disclose the APIs used by that middleware product. But powerful business considerations militate against Microsoft adopting a strategy in which *only* purchasers of new PCs, or of box-packaged versions of Windows, receive a middleware product offered by Microsoft. Under such a strategy, Microsoft would be unable to supply the middleware product to *any* of the millions of Windows users worldwide who comprise its installed user base. Microsoft would thereby put itself at a competitive disadvantage as suppliers of competing middleware offered attractive product features to the installed base of Windows users.

This particular provision — sometimes referred to as the “client/server interoperability” section — was especially important to the States. The provision included in the November 2 version of the final judgment between the DOJ and Microsoft did not seem to us in New York to go quite as far as we felt it needed to go. As a result, this was a place that we and other States focused on in the negotiations leading to the revised settlement signed on November 6. The changes that resulted did not involve many words, but we believe that they enhanced Microsoft’s disclosure obligations in this critical area.

## **5. The Enforcement Mechanism**

The subject matter of the Microsoft lawsuit is complex, and so too are many parts of the remedy embodied in the final judgment. This complexity creates the potential for good faith disagreement, as well as for intentional evasion. For this reason, from the outset of the settlement negotiations, New York held to the view that enforcement provisions going beyond those typically found in antitrust decrees would be needed here. We worked closely with DOJ to achieve this objective. What you find in the proposed final judgment is an enforcement mechanism that we believe is unprecedented in any antitrust case.

The proposed consent decree expressly recognizes the “exclusive responsibility” of the United States DOJ and the antitrust officials of the settling

States to enforce the final judgment against Microsoft. (Section IV, paragraph A (1)) To assist this federal and state enforcement and compliance effort, the proposed decree will create a three person body, the "Technical Committee" or "TC." (Section IV, paragraph B) The TC is empowered, among other things: (1) to interview any Microsoft personnel; (2) to obtain copies of any Microsoft documents — including Microsoft's source code — and access to any Microsoft systems, equipment and physical facilities; and (3) to require Microsoft to provide compilations of documents, data and other information, and to prepare reports for the TC. (Section IV, paragraph B(8)(b), (c)) The TC itself is authorized to hire staff and consultants to carry out its responsibilities. (Section IV, paragraph B(8)(h)) Microsoft also is required to provide permanent office space and office support facilities for the TC at its Redmond, Washington campus. (Section IV, paragraph B(7))

In other words, for the five year term of the decree, the TC will be the on-site eyes and ears of the government enforcers. The TC and government enforcers may communicate with each other as often as they need to, and the TC may obtain advice or assistance from the enforcers on any matter within the TC's purview. In addition, the TC is subject to specific reporting requirements — every six months, or immediately if the TC finds any violation of the decree. (Section IV, paragraph B(8)(e), (f)) The TC further will be expected to field and promptly resolve

complaints and inquiries from industry members, or from government enforcers themselves. (Section IV, paragraph B(8)(d), paragraph D)

All of this will be paid for by Microsoft, subject to possible review by federal and state officials, or the Court. To discourage Microsoft from mounting dubious court challenges to the TC's costs and expenses, the proposed decree authorizes the TC to recover its litigation expenses, including attorneys' fees, unless the Court expressly finds that the TC's opposition was "without substantial justification." (Section IV, paragraph B(8)(i))

These enforcement provisions are probably the strongest ever crafted in an antitrust case. Federal and state enforcers will have at their disposal their regular enforcement powers, which may be invoked at any time independent of anything that the TC may do. (Section IV, paragraph A(2), (4)) Meanwhile, the TC will augment these traditional powers in significant respects. In addition, Microsoft itself is required to appoint an internal compliance officer to assist in assuring discharge of the company's obligations under the settlement. (Section IV, paragraph C)

I am mindful that concern has been expressed regarding the enforcement provision that "[n]o work product, findings or recommendations of the TC may be admitted in any enforcement proceeding before the Court . . . ." (Section IV, paragraph D(4)(d)) But the impact of this provision should not be great. As noted,

the TC may report to the government enforcers, who may use the TC's work to seek from Microsoft a consensual resolution of, for example, any non-compliant conduct, to initiate (and inevitably shortcut) enforcement-looking activity, to pursue leads, and for other enforcement purposes. Moreover, the TC's work product, once known, should be readily susceptible of prompt replication by enforcement officials for use in judicial proceedings.

## **6. The Settlement Process**

As the very fact of these hearings attests, the proposed settlement of the Microsoft case is a subject of significant public interest and debate. For years, many have asserted that the case itself should never have been filed to begin with. For these individuals, the government should be satisfied to get any remedy at all. We in New York profoundly disagree with this view. As the liability trial and appeal confirmed, this case was properly brought to remedy serious anticompetitive activity by Microsoft. The trial and appellate proceedings further confirmed that the antitrust laws are alive and well in technological industries, just as they are in other parts of our nation's economy. Accordingly, the public is entitled to a strong, effective remedy.

In this regard, however, some have criticized the settlement for not going far enough, or for having exceptions and limitations. We reject this view as well.

In announcing the decision by New York and eight other States to settle the case, New York Attorney General Eliot Spitzer noted that “a settlement is never perfect.” A settlement is an agreed-upon resolution of competing positions and objectives. Do I wish that the DOJ and the States had gotten more? Of course I do. Do our counterparts on the Microsoft side wish that they had given up less? There is no doubt about the answer. So, asking these questions does not take us very far. Settlement necessarily means compromise. It is in the nature of the beast.

This particular settlement is the product of roughly five weeks of consuming negotiations, much of which took place under the guidance of two experienced mediators. I am unaware of any calculation of the total person-hours consumed by this effort. Certainly it was in the thousands, if not tens of thousands, of hours. The process required the two sides to explore, both internally and in face-to-face negotiations, a host of factors that bear on terms of the settlement eventually reached, such as: (1) the competitive consequences of varying courses of action; (2) the design, engineering and practical implications and limitations of various remedy approaches, as well as their impact on innovation incentives; (3) the issues actually framed for trial in the liability phase of the case and their resolution by the Court of Appeals; (4) the law governing remedies for the monopoly maintenance violation that the Court of Appeals upheld, which the District Court would be called on to apply in the

absence of a settlement; and (5) the resources, effort and time otherwise needed to resolve the sharp factual disputes that would be presented in a full-blown remedies hearing. New York and the other States, as well as the DOJ, were aided in this process by experienced staff and retained experts.

In the final analysis, the DOJ, New York and the other settling States concluded that the benefits to consumers and to the competitive process that are likely to result from the negotiated settlement reached here outweigh the uncertain remedy that a contested remedies proceeding might bring. In assessing the soundness of that conclusion, the members of the Committee should recall that the settlement's critics have a luxury that those of us who settled did not have: they have the settlement floor created by the final judgment that we have offered. Absent this settlement, however, a judicial remedies hearing had not simply potential rewards, but significant risks as well.

During the September 28 court conference, the District Court expressed its views regarding the appropriate scope of the conduct remedies that might emerge from a judicial hearing on relief. Among other things, the District Court stated the following:

The Supreme Court long ago stated that it's entirely appropriate for a district court to order a remedy which goes beyond a simple prescription against the

precise conduct previously pursued . . . . The Supreme Court has vested this court with large discretion to fashion appropriate restraints both to avoid a recurrence of the violation and to eliminate its consequences. Now, case law in the antitrust field establishes that the exercise of discretion necessitates choosing from a range of alternatives.

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So the government's first and most obvious task is going to be to determine which portions of the former judgment remain appropriate in light of the appellate court's ruling and which portions are unsupported following the appellate court's narrowing of liability.

Now, the scope of any proposed remedy must be carefully crafted so as to ensure that the enjoining conduct falls within the number [*sic*, penumbra] of behavior which was found to be anticompetitive. The government will also have to be cautiously attentive to the efficacy of every element of the proposed relief.

(Transcript of September 28, 2001 proceedings, pages 9, 8)

These remarks highlight risks that both sides confronted if the decision were made to press for a court-ordered remedy. Several concrete examples, from the settlement actually reached, will further drive home this point.

- Microsoft's API disclosure obligations, and its obligations to permit OEMs to customize the Windows desktop and operating system more generally, revolve around a series of related middleware definitions that the parties agreed to. Absent a settlement, there could no assurance that



the courts would adopt middleware definitions as broad as those that DOJ and the settling States negotiated.

- The liability trial in the case centered on Microsoft's conduct directed to efforts by Netscape and Sun to get Netscape's web browser and Sun's Java technologies installed on individual PCs. Plaintiffs' theory of the case — which the trial and appellate courts upheld — was that these forms of middleware could, if sufficiently pervasive at the PC level, erode the applications barrier to entry that protects Microsoft's Windows monopoly. Microsoft therefore set out to exclude this middleware from PCs. In the settlement negotiations leading to the client/server interoperability provision, the government negotiators argued that applications running at the server level can be analogous to middleware running at the PC level. On this approach, middleware developed at the server level could also break down the applications barrier to entry into the PC operating system market. Therefore, the remedy in this case requires Microsoft to disclose ways that PCs running Windows talk to servers running Microsoft software. Absent a settlement, however, there could be no assurance that the courts would order disclosure of this PC/server line of communications. Microsoft resisted this provision

during the settlement negotiations, and would similarly have opposed it at a remedies hearing.

- Finally, as I noted above, there does not seem to be any antitrust precedent for an enforcement mechanism that puts a monitor on site, with full access to the defendant's documents, employees, systems and physical facilities — all at the defendant's expense. Absent a settlement, Microsoft would have vigorously opposed such a far-reaching enforcement regime, and there plainly could be no assurance that the courts would have ordered comparable relief.

As these examples reflect, I believe that the proposed final judgment compares favorably to — and in some respects may well exceed — the remedy that might have emerged from a judicial hearing.

The existence of a settlement has also accelerated the point in time at which a remedy will begin to take effect. Microsoft has agreed to begin complying with the proposed final judgment starting on December 16, 2001. (November 6 Stipulation, paragraph 2) Assuming further that the District Court approves the proposed final judgment in Tunney Act proceedings in early 2002, there will be a remedy in place a year or more before the trial and appellate level proceedings, needed to resolve the appropriate remedy in the absence of a settlement, would be concluded. In this

rapidly changing sector of the industry, the timeliness of a remedy is an important consideration.

## **6. Conclusion**

In sum, the settlement in the Microsoft case promotes competition and consumer choice. It is proportionate to the monopoly maintenance violations that the Court of Appeals for the District of Columbia Circuit sustained. The settlement represents a fair and reasonable vindication of the public interest in assuring the free and open competition that our nation's antitrust laws guarantee.

Microsoft is reported recently to have issued a companywide email stating its commitment to making the settlement "a success" and to "ensuring that everyone at Microsoft complies fully with the terms" of the decree. D. Ian Hopper, Associated Press State & Local Wire (Nov. 30, 2001). We expect nothing less, and we intend to see to it that Microsoft honors that commitment. New York is one of the members of the States' enforcement committee, created under the proposed decree. Our State Antitrust Bureau will be vigilant in monitoring Microsoft's discharge of its obligations, and we look forward to working closely with the DOJ to make sure that the settlement is, indeed, a success. The American public is entitled to nothing less.

**Statement of Charles F. (Rick) Rule  
Fried Frank Harris Shriver & Jacobson  
Counsel for Microsoft Corporation**

**Before the Committee on the Judiciary  
United States Senate  
December 12, 2001**

Mr. Chairman and members of the Committee, good morning. It is a pleasure to appear before you today on behalf of Microsoft Corporation to discuss the proposed consent decree or Revised Proposed Final Judgment (the "PFJ") to which the U.S. Department of Justice and nine of the plaintiff states have agreed. As this committee is aware, I am counsel to Microsoft in the case and was one of the principal representatives for the company in the negotiations that led to the proposed consent decree.

The PFJ was signed on November 6th after more than a month of intense, around-the-clock negotiations with the Department and representatives of all the plaintiff states. The decree is currently subject to a public interest review by Judge Kollar-Kotelly under the Tunney Act<sup>1</sup>. Because we are currently in the midst of that review and because nine states and the District of Columbia have chosen to continue the litigation, I must be somewhat circumspect in my remarks. However, what I can -- indeed, must -- stress is that, in light of the Court of Appeals' decision last summer to "drastically" reduce the scope of Microsoft's liability and in light of the legal standards for imposing injunctive relief, the Department and the settling states were very effective in negotiating for broad, strong relief. As the chart in the appendix depicts, ever since the Department and the plaintiff states first filed their complaints in May 1998, the case has been shrinking. What began with five claims, was whittled down to a single monopoly maintenance claim by a unanimous Court of Appeals. Even with respect to that surviving claim, the appellate court affirmed Judge Jackson's findings on only about a third (12 of 35) of the specific acts which the district court had found support that claim.

Given that history and the law, there is no reasonable argument that the PFJ is too narrow or that it fails to achieve all the relief to which the Department was entitled. In fact, as these remarks explain, the opposite is true -- faced with tough, determined negotiators on the other side of the table, Microsoft agreed to a decree that goes substantially beyond what the plaintiffs were likely to achieve through litigation. Quite frankly, the PFJ is the strongest, most regulatory conduct decree ever obtained (through litigation or settlement) by the Department.

Why then, one might ask, would Microsoft consent to such a decree? There are two reasons. First, the company felt strongly that it was important to put this matter behind it and to move forward constructively with its customers, its business partners, and the government. For four years, the litigation has consumed enormous resources and been a serious

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<sup>1</sup> 15 U.S.C. § 16(b)-(h).

distraction. The constant media drumbeat has obscured the fact that the company puts a premium on adhering to its legal obligations and on developing and maintaining excellent relationships with its partners and customers. Litigation is never a pleasant experience, and given the magnitude of this case and the media attention it attracted, it is hard to imagine any more costly, unpleasant civil litigation.

Second, while the Department pushed Microsoft to make substantial, even excessive concessions to get a settlement, there were limits to how far the company was willing or able to go (limits, by the way, which the Department and the settling states managed to reach). Microsoft was fighting for an important principle -- the ability to innovate and improve its products and services for the benefit of consumers. To that end, Microsoft insisted that the decree be written in a way to allow the company to engage in legitimate competition on the merits. Despite the substantial burdens the decree will impose on Microsoft and the numerous ways in which Microsoft will be forced to alter its conduct, the decree does preserve Microsoft's ability to innovate, to improve its products, and to engage in procompetitive business conduct that is necessary for the company to survive.

In short, at the end of the negotiations, Microsoft concluded that the very real costs that the decree imposes on the company are outweighed by the benefits, not just to Microsoft but to the PC industry and consumers generally.

### *The Court of Appeals' "Road Map" for Relief*

In order to evaluate the decree, one must first appreciate the history of this case and how drastically the scope of Microsoft's liability was narrowed at the appellate level. When this case began with the filing of separate complaints by the Department and the plaintiff states in May of 1998, it was focused on Microsoft's integration of browsing functionality called Internet Explorer or IE into Windows 98, which the plaintiffs alleged to be an illegal tying arrangement.

The complaints of the Department and the states included five separate claims: (1) a claim under section 1 of the Sherman Act that the tie-in was per se illegal; (2) another claim under section 1 that certain promotion and distribution agreements with Internet service providers (ISPs), Internet content providers (ICPs), and on-line service providers (OSPs) constituted illegal exclusive dealing; (3) a claim under section 2 of the Sherman Act that Microsoft had attempted to monopolize Web browsing software; (4) a catch-all claim under section 2 that the alleged conduct that underlay the first three claims amounted to illegal maintenance of Microsoft's monopoly in PC operating systems; and (5) a claim by the plaintiff states (but not part of the Department's complaint) under section 2 that Microsoft illegally "leveraged" its monopoly in PC operating systems.<sup>2</sup> As discovery got underway, the case

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<sup>2</sup> Initially the plaintiff states included an additional section 2 claim based on Microsoft Office; however, they voluntarily dropped that claim in their amended complaint.

dramatically expanded as the plaintiffs indiscriminately began identifying all manner of Microsoft conduct as examples of the company's illegal efforts to maintain its monopoly. But then, the case began to shrink.

- In response to Microsoft's motion for summary judgment, the district court dismissed the states' Monopoly leveraging claim (claim 5).
- After trial, Judge Jackson held that the plaintiffs failed to prove that Microsoft's arrangements with ISPs, ICPs, and OSPs violated section 1 (claim 2).
- Judge Jackson did, however, conclude that the plaintiffs had sustained their claims that Microsoft illegally tied IE to Windows (claim 1), illegally attempted to monopolize the browser market (claim 3), and illegally maintained its monopoly (claim 4), basing his decision on 35 different actions engaged in by Microsoft.
- In a unanimous decision of the Court of Appeals sitting *en banc*, the court reversed the trial court on the attempted monopolization claim (claim 3) and remanded with instructions that judgment be entered on that claim in favor of Microsoft.
- The unanimous court also reversed Judge Jackson's decision with respect to the tie-in claim (claim 1). The appellate court held that, in light of the prospect of consumer benefit from integrating new functionality into platform software such as Windows, Microsoft's integration of IE into Windows had to be judged under the rule of reason rather than the per se approach taken by Judge Jackson. The Court of Appeals refused to apply the per se approach because of "our qualms about redefining the boundaries of a defendant's product and the possibility of consumer gains from simplifying the work of applications developers [by ensuring the ubiquitous dissemination of compatible APIs]." The court's decision did allow the plaintiffs on remand to pursue the tie-in claim on a rule of reason theory; however, shortly after the remand, the plaintiffs announced they were dropping the tie-in claim.
- With respect to the only remaining claim (monopoly maintenance - claim 4), the Court of Appeals affirmed in part and reversed in part the lower court and substantially shrank Microsoft's liability. After articulating a four-step burden-shifting test that is highly fact intensive, the appellate court reviewed the 35 different factual bases for liability and rejected nearly two-thirds of them.
  - In the case of seven of those 35 findings (concerning such conduct as Microsoft's refusal to allow OEMs to replace the Windows desktop, Microsoft's design of Windows to "override the user's choice of a default browser," and Microsoft's development of a Java virtual machine (JVM) that was incompatible with Sun's JVM), the appellate court specifically reversed Judge Jackson's decision.

At the time Judge Kollar-Kotelly ordered the parties into intensive negotiations, she clearly recognized the importance of the drastic alteration to the scope of Microsoft's liability.<sup>6</sup> The judge informed the government that its "first and most obvious task is going to be to determine which portions of the former judgment remain appropriate in light of the appellate court's ruling and which portions are unsupported following the appellate court's narrowing of liability."<sup>7</sup> The judge went on to note that "the scope of any proposed remedy must be carefully crafted so as to ensure that the enjoining conduct falls within the [penumbra] of behavior which was found to be anticompetitive."<sup>8</sup> The judge also stated that "Microsoft argues that some of the terms of the former judgment are no longer appropriate, and that is correct. I think there are certain portions where the liability has been narrowed."<sup>9</sup>

Before discussing the negotiations and the decree itself, I would like to make three other points about the crafting of antitrust remedies that also are relevant to considering the relief to which the plaintiffs were entitled. First, the critics of the PFJ routinely ignore the fact that the Department has long acknowledged that Microsoft lawfully acquired its monopoly position in PC operating systems. Indeed, the Department retained a Nobel laureate in the first Microsoft case in 1994 to submit an affidavit to the district court opining that Microsoft had reached its position in PC operating systems through luck, skill, and foresight.<sup>10</sup> It is true of course that Microsoft has now been found liable for engaging in conduct that amounted to illegal efforts to maintain that position; however, there is precious little in the record establishing any causal link between the twelve illegal acts of "monopoly maintenance" and Microsoft's current position in the market for PC operating systems. Thus, contrary to the critics' overheated rhetoric, there is no basis for relief designed to terminate an "illegal monopoly."

Second, decrees in civil antitrust cases are designed to remedy, not to punish. All too often, the critics of this decree speak as though Microsoft was convicted of a crime. It was not. This is a civil case, subject to the rules of civil rather than criminal procedure. To the extent the plaintiffs tried to get relief that could be deemed punitive, that relief would have been rejected.

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<sup>6</sup> This hearing, it should be noted, occurred after the plaintiffs had dropped their request for divestiture relief.

<sup>7</sup> Transcript of Scheduling Conference before the Honorable Colleen Kollar-Kotelly, September 28, 2001, at 8.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> The Declaration of Kenneth J. Arrow was attached as an exhibit to the Memorandum of the United States in Support of Motion to Enter Final Judgment, filed on January 18, 1995, with the District Court in support of the Department's 1994 consent decree with Microsoft.

Third, a decree must serve the purposes of the antitrust laws, which is a “consumer welfare prescription.” I realize we are in the “season of giving,” but an antitrust decree is not a Christmas tree to fulfill the wishes of competitors, particularly where that fulfillment comes at the expense of consumer welfare. Calls for royalty-free licensing of Microsoft’s intellectual property, or for imposing obligations on Microsoft to distribute third party software at no charge, or for Microsoft to facilitate the distribution of an infinite variety of bastardized versions of Windows (and make sure they all run perfectly) are great for a small group of competitors who know that such provisions will quickly destroy Microsoft’s incentives and ability to compete (not to mention violate the Constitution’s proscription against “takings”). Such calls, however, are anathema to consumers’ interests in a dynamic, innovative computer industry. Twenty years ago, my old boss and antitrust icon, Bill Baxter, warned about the anticompetitive consequences of antitrust decrees designed simply to “add sand to the saddlebags” of a particularly fleet competitor like Microsoft. It’s a warning the courts would certainly heed today.

To their credit, the negotiators for the Department and the settling states understood these three fundamental antitrust principles. While we may have had to remind the other side of these principles from time to time, we did not have to negotiate for their adherence to them. Taxpayers and consumers can be proud that their interests were represented by honorable men and women with the utmost respect for the rule of law. For others to insinuate that, by agreeing to a decree that honors these three fundamental principles, the Department and the settling states “caved” or settled for inadequate relief is as offensive as it is laughable.

### *The Negotiations*

It is against the background I have sketched that, on September 27th, Judge Kollar-Kotelly ordered the parties into intensive, “around the clock” negotiations. Microsoft had already indicated publicly its strong desire to try to settle the case, and so it welcomed the judge’s order. As has been widely reported, all the parties in the case took the court’s order very seriously. Microsoft assembled in Washington, D.C., a core team of in-house and outside lawyers who have been living with this case for years, and who spent virtually all of the next five weeks camped out in my offices down the street. Microsoft’s top legal officer was in town during much of the period directing the negotiations. Back in Redmond, the company’s most senior executives devoted a great deal of time and energy to the process, and we were all supported by a large group of dedicated lawyers, businesspeople, and staff.

From my vantage point, the Department and the states (at least those that settled) made an equivalent effort. As the mediator wrote after the process ended, “No party was left out of the negotiations. ... Throughout most of the mediation the 19 states (through their executive committee representatives) and the federal government (through the staff of the antitrust division) worked as a combined ‘plaintiffs’ team.”<sup>11</sup> Jay Himes from the office of the New

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<sup>11</sup> Eric D. Green and Jonathan B. Marks, How We Mediated the Microsoft Case, Boston Globe, at A23 (November 15, 2001).



York Attorney General Eliot Spitzer and Beth Finnerty from the office of the Ohio Attorney General Betty Montgomery represented the states throughout the negotiations, putting in the same long hours as the rest of us. At various points Mr. Himes and Ms. Finnerty were joined by representatives from other states, including Kevin O'Connor from the office of Wisconsin Attorney General James Doyle.<sup>12</sup>

The negotiations began on September 28th and continued virtually non-stop until November 6th. During the first two weeks, we negotiated without the benefit of a mediator. As they say in diplomatic circles, the discussions were "full and frank." The Department lawyers and the state representatives in the negotiation were extremely knowledgeable, diligent, and formidable.

Microsoft certainly hoped to be able to reach a settlement quickly and before a mediator was designated. However, the views on all sides were sufficiently strong and the need to pay attention to every sentence, phrase, and punctuation mark so overwhelming that reaching agreement proved impossible in those first two weeks. Eric Green, a prominent mediation specialist, was appointed by the court and with the help of Jonathan Marks spent the next three weeks helping the parties find common ground. As Professor Green and Mr. Marks wrote after the mediation ended,

"Successful mediations are ones in which mediators and parties work to identify and overcome barriers to reaching agreement. Successful mediations are ones in which all the parties engage in reasoned discussions of issues that divide them, of options for settlement, and of the risks, opportunities, and costs that each party faces if a settlement isn't reached. Successful mediations are ones in which, settle or not, senior representatives of each party have made informed and intelligent decisions. The Microsoft mediation was successful."<sup>13</sup>

Working day and night virtually until the original November 2 deadline set by the judge, Microsoft and the Department agreed to and signed a decree early on November 2. The representatives of the states also tentatively agreed, subject to an opportunity from November 2 until November 6 to confer with the other states that were more removed from the case and negotiations. During that period, the states requested several clarifying modifications to which Microsoft (and the Department) agreed. From press reports, it appears that during this period the plaintiff states also were being subjected to intense lobbying by a few of Microsoft's competitors who were desperate either to get a decree that would severely cripple if not eventually destroy Microsoft or at least to keep the litigation (and the attendant costs imposed on Microsoft) going. Notwithstanding that pressure, New York, Wisconsin, and Ohio -- the states that had made the largest investment in litigating against Microsoft and in negotiating a settlement -- along with six

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<sup>12</sup> Mr. O'Connor, as well as attorneys in the office of the New York Attorney General, had served as counsel of record for the states in the litigation.

<sup>13</sup> Green and Marks, supra fn.11.

other plaintiff states represented by a bipartisan group of state attorneys general signed onto the Revised PFJ on November 6.

### *The Proposed Final Judgment*

Throughout the negotiations, Microsoft was confronted by a determined and tough group of negotiators for the Department and the states. They made clear that there would be no settlement unless Microsoft went well beyond the relief to which, Microsoft believes, the Court of Appeals opinion and the law entitles the plaintiffs. Once that became clear, Microsoft relented in significant ways, subject only to narrow language that preserved Microsoft's ability to innovate and engage in normal, clearly procompetitive activities. Professor Green, the one neutral observer of this drama, has noted the broad scope of the prohibitions and obligations imposed on Microsoft by the PFJ, stating during the status conference with Judge Kollar-Kotelly that "the parties have not stopped at the outer limits of the Court of Appeals' decision, but in some important respects the proposed final judgment goes beyond the issues affirmed by the Court of Appeals to deal with issues important to the parties in this rapidly-changing technology."<sup>14</sup>

I do not intend today to provide a detailed description of each provision of the PFJ; the provisions speak for themselves. It may come as something of a surprise in light of some of the uninformed criticism hurled at the decree, but one of Microsoft's principal objectives during the negotiations was to develop proscriptions and obligations that were sufficiently clear, precise and certain to ensure that the company and its employees would be able to understand and comply with the decree without constantly engendering disputes with the Department. This is an area of complex technology and the decree terms on which the Department insisted entailed a degree of technical sophistication that is unprecedented in an antitrust decree. Drafting to these specifications was not easy, but the resulting PFJ is infinitely clearer and easier to administer than the conduct provisions of the decree that Judge Jackson imposed in June 2000.

If, as one might suspect would be the outcome in a case such as this, the PFJ were written to proscribe only the twelve practices affirmed by the Court of Appeals, the decree would be much shorter and simpler. The Department and settling states, however, insisted that the decree go beyond just focused prohibitions to create much more general protections for a potentially large category of software, which the PFJ calls "middleware." But even these expansive provisions to foster middleware competition were not sufficient to induce the Department and the states to settle; rather, they insisted that Microsoft also agree to additional obligations that bear virtually no relationship to any of the issues addressed by the district court and the Court of Appeals. And lastly they insisted on unprecedented enforcement provisions. I will briefly describe each of these three sets of provisions.

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<sup>14</sup> Transcript of Status Conference before the Honorable Colleen Kollar-Kotelly, November 2, 2001, at 5.

## 1. Protections for "Middleware"

The case that the plaintiffs tried and the narrowed liability that survived appellate review all hinged on claims that Microsoft took certain actions to exclude Netscape's Navigator browser and Sun's Java technology from the market in order to protect the Windows operating system monopoly. The plaintiffs successfully argued that Microsoft feared that Navigator and Java, either alone or together, might eventually include and expose a broad set of general purpose APIs to which software developers could write as an alternative to the Windows APIs. Since Navigator and Java can run on multiple operating systems, if they developed into general purpose platforms, Navigator and Java would provide a means of overcoming the "applications barrier" to entry and threaten the position of the Windows operating system as platform software.

A person might expect that a decree designed to address such a monopoly maintenance claim would provide relief with respect to Web-browsing software and Java or, at most, to other general purpose platform software that exposes a broad set of APIs and is ported to run on multiple operating systems. The PFJ goes much further. The Department insisted that obligations imposed on Microsoft by the decree extend to a range of software that has little in common with Navigator and Java. The decree applies to "middleware" broadly defined to include, in addition to Web-browsing software and Java, instant messaging software, media players, and even email clients -- software that, Microsoft believes, has virtually no chance of developing into broad, general purpose platforms that might threaten to displace the Windows platform. In addition, there is a broad catch-all definition of middleware that in the future is likely to sweep other similar software into the decree.

This sweeping definition of middleware is significant because of the substantial obligations it imposes on Microsoft. Those obligations -- a number of which lack any correspondence to the monopoly maintenance findings that survived appellate review -- are intended to create protections for all the vendors of software that fits within the middleware definition. Taken together, the decree provisions provide the following protections and opportunities:

- *Relations with Computer Makers.* Microsoft has agreed not to retaliate against computer makers who ship software that competes with anything in its Windows operating system.
- *Computer Maker Flexibility.* Microsoft has agreed to grant computer makers broad new rights to configure Windows so as to promote non-Microsoft software programs that compete with features of Windows. Computer makers will now be free to remove the means by which consumers access important features of Windows, such as Internet Explorer, Windows Media Player, and Windows Messenger. Notwithstanding the billions of dollars Microsoft invests developing such cool new features, computer makers will now be able to replace access to them in order to give prominence to non-Microsoft software such as programs from AOL Time Warner or RealNetworks. (Additionally, as is the case today, computer makers can provide consumers with a choice --that is to say access to Windows features as well as to non-Microsoft software programs.)

- *Windows Design Obligations.* Microsoft has agreed to design future versions of Windows, beginning with an interim release of Windows XP, to provide a mechanism to make it easy for computer makers, consumers and software developers to promote non-Microsoft software within Windows. The mechanism will make it easy to add or remove access to features built in to Windows or to non-Microsoft software. Consumers will have the freedom to choose to change their configuration at any time.
- *Internal Interface Disclosure.* Even though there is no suggestion in the Court of Appeals' decision that Microsoft fails to disclose APIs today and even though the Court of Appeals' holding on monopoly power is predicated on the idea that there are tens of thousands of applications written to call upon those APIs, Microsoft has agreed to document and disclose for use by its competitors various interfaces that are internal to Windows operating system products.
- *Relations with Software Developers.* Microsoft has agreed not to retaliate against software or hardware developers who develop or promote software that competes with Windows or that runs on software that competes with Windows.
- *Contractual Restrictions.* Microsoft has agreed not to enter into any agreements obligating any third party to distribute or promote any Windows technology exclusively or in a fixed percentage, subject to certain narrow exceptions that apply to agreements raising no competitive concern. Microsoft has also agreed not to enter into agreements relating to Windows that obligate any software developer to refrain from developing or promoting software that competes with Windows.

These obligations go far beyond the twelve practices that the Court of Appeals found to constitute monopoly maintenance. One of the starkest examples of the extent to which these provisions go beyond the Court of Appeals decision relates to Microsoft's obligations to design Windows in such a way as to give third parties the ability to designate non-Microsoft middleware as the "default" choice in certain circumstances in which Windows might otherwise be designed to utilize functionality integrated into Windows. As support for his monopoly maintenance conclusion, Judge Jackson had relied on several circumstances in which Windows was designed to override the end users' choice of Navigator as their default browser and instead to invoke IE. The Court of Appeals, however, reviewed those circumstances and reversed Judge Jackson's conclusion on the ground that Microsoft had "valid technical reasons" for designing Windows as it did. Notwithstanding this clear victory, Microsoft acceded to the Department's demands that it design future versions of Windows to ensure certain default opportunities for non-Microsoft middleware.

## 2. Uniform Prices and Server Interoperability

Nevertheless, agreeing to this wide range of prohibitions and obligations designed to encourage the development of middleware broadly defined was not enough to get the plaintiffs to settle. Instead, they insisted on two additional substantive provisions that have absolutely no correspondence to the findings of monopoly maintenance liability that survived appeal.

- *Uniform Price List.* Microsoft has agreed to license its Windows operating system products to the 20 largest computer makers (who collectively account for the great majority of PC sales) on identical terms and conditions, including price (subject to reasonable volume discounts for computer makers who ship large volumes of Windows).
- *Client/Server Interoperability.* Microsoft has agreed to make available to its competitors, on reasonable and non-discriminatory terms, any protocols implemented in Windows desktop operating systems that are used to interoperate natively with any Microsoft server operating system.

In the case of the sweeping definition of middleware and the range of prohibitions and obligations imposed on Microsoft, there is at least a patina of credibility to the argument that the penumbra of the twelve monopoly maintenance practices affirmed by the Court of Appeals can be stretched to justify those provisions, at least as “fencing in” provisions. There is no sensible reading of the Court of Appeals decision that would provide any basis for requiring Microsoft to charge PC manufacturers uniform prices or to make available the proprietary protocols used by Windows desktop operating systems and Windows server operating systems to communicate with each other. Nevertheless, because the plaintiffs insisted that they would not settle without those two provisions, Microsoft also agreed to them.

Before turning to the enforcement provisions of the PFJ, I want to say a word about the few provisos included in the decree that provide narrow exceptions to the various prohibitions and obligations imposed on Microsoft. Those exceptions were critical to Microsoft’s willingness to agree to the sweeping provisions on which the plaintiffs insisted. Without these narrowly tailored exceptions, Microsoft could not innovate or engage in normal procompetitive commercial activities. The public can rest assured that the settling plaintiffs insisted on language to ensure that the exceptions only apply when they promote consumer welfare. For example, some companies that compete with Microsoft for the sale of server operating systems apparently have complained about the so-called “security carve-out” to Microsoft’s obligation to disclose internal interfaces and protocols. That exception is very narrow and only allows Microsoft to withhold encryption “keys” and the similar mechanisms that must be kept secret if the security of computer networks and the privacy of user information is to be ensured. In light of all the concern over computer privacy and security these days, it is surprising that there is any controversy over such a narrow exception.

### **3. Compliance and Enforcement**

The broad substantive provisions of the PFJ are complemented by an unusually strong set of compliance and enforcement provisions. Those provisions are unprecedented in a civil antitrust decree. The PFJ creates an independent three-person technical committee, resident on the Microsoft campus, with extraordinary powers and full access to Microsoft facilities, records, employees and proprietary technical data, including Windows source code, which is the equivalent of the “secret formula” for Coke. The technical committee provides a level of technical oversight that is far more substantial than any provision of any other antitrust decree of

which I am aware. At the insistence of the plaintiffs, the technical committee does not have independent enforcement authority; rather, reports to the plaintiffs and, through them, to the court. The investigative and oversight authority of the technical committee in no way limits or reduces the enforcement powers of the DOJ and states; rather, the technical committee supplements and enhances those powers. Each of the settling states and DOJ have the power to enforce the decree and have the ability to monitor compliance and seek a broad range of remedies in the event of a violation.

Microsoft also agreed to develop and implement an internal antitrust compliance program, to distribute the decree and educate its management and employees as to the various restrictions and obligations. In recent years, Microsoft has assembled in-house one of the largest, most talented groups of antitrust lawyers in corporate America. They are already engaged in substantial antitrust compliance counseling and monitoring. The decree formalizes those efforts, and quite frankly adds very substantially to the in-house lawyers' work. As we speak, that group, together with key officials from throughout the Microsoft organization, are working to implement the decree and to ensure the company's compliance with it.

As with the substantive provisions, Microsoft agreed to these unprecedented compliance and enforcement provisions because of the adamance of the plaintiffs and because of the highly technical nature of the decree. Microsoft, the Department, and the settling states recognized that it was appropriate to include mechanisms -- principally, the technical committee -- that will facilitate the prompt and expert resolution of any technical disputes that might be raised by third parties, without in any way derogating from the government's full enforcement powers under the decree. Although the enforcement provisions are unprecedented in their stringency and scope, they are not necessitated or justified by any valid claim that Microsoft has failed to comply with its decree obligations in the past. In fact, Microsoft has an exemplary record of complying with the consent decree to which the company and the Department agreed in 1994. In 1997, the Department did question whether Microsoft's integration of IE into Windows 95 violated a "fencing in" provision that prohibited contractual tie-ins, but Microsoft was ultimately vindicated by the Court of Appeals.<sup>15</sup> Microsoft has committed itself to that same level of dedication in ensuring the company's compliance with the PFJ.

### *Conclusion*

The PFJ strikes an appropriate balance in this complicated case, providing opportunities and protections for firms seeking to compete while allowing Microsoft to continue to innovate and bring new technologies to market. The decree is faithful to the fact that the antitrust laws are a "consumer protection prescription," and it ensures an economic environment in which all parts of the PC-ecosystem can thrive.

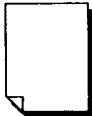

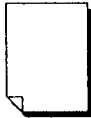
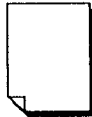
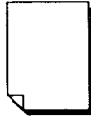
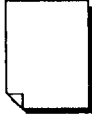
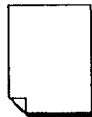
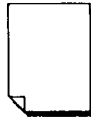


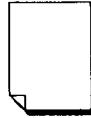
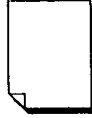

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<sup>15</sup> United States v. Microsoft, 147 F.3d 935 (D.C.Cir. 1998).

Make no mistake, however, the PFJ is tough. It will impose substantial new obligations on the company, and it will require significant changes in the way Microsoft does business. It imposes heavy costs on the company and entails a degree of oversight that is unprecedented in a civil antitrust case. For some competitors of Microsoft, however, apparently nothing short of the destruction of Microsoft -- or at least the ongoing distraction of litigation -- will be sufficient. But if the objective is to protect the interests of consumers and the competitive process, then this decree more than achieves that goal.

Finally, for all those who are worried about the future and what unforeseen developments may not be covered by this case and the decree, remember that the Court of Appeals decision now provides guideposts, which previously did not exist, for judging Microsoft's behavior, and that of other high technology companies, going forward. Those guidelines, it is true, are not always easy to apply ex ante to conduct; however, now that the Court of Appeals has spoken, we all have a much better idea of the way in which section 2 of the Sherman Act applies to the software industry. In short, what antitrust law requires of Microsoft is today much clearer than it was when this case began. We have all learned a lot over the last four years, and Microsoft has every incentive to ensure that history does not repeat itself.

# The Court of Appeals' Roadmap for Relief

	Initial Claims	At Trial	District Court Decision	Appeals Court Decision
<b>Monopoly Leveraging</b>				
<b>Exclusive Distribution</b>				
<b>Tying</b>				
<b>Attempted Monopolization</b>				
<b>Monopoly Maintenance Findings</b>				



Testimony of  
Professor Lawrence Lessig,  
Stanford Law School,  
before the  
Senate Committee on the Judiciary  
at its hearing:  
The Microsoft Settlement: A Look to the Future  
December 12, 2001

Four years after the United States government initiated legal action against the Microsoft Corporation, Microsoft, the federal government, and nine states have agreed upon a consent decree ("the proposed decree") to settle the finding of antitrust liability that the Court of Appeals for the D.C. Circuit has unanimously affirmed. In my view, that consent decree suffers from a significant, if narrow, flaw. While it properly enlists the market as the ultimate check on Microsoft's wrongful behavior, it fails to provide an adequate mechanism of enforcement to implement its requirements. If it is adopted without modification, it will fail to achieve the objectives that the government had when it brought this case.

Yet while it is important that an adequate and effective remedy be imposed against Microsoft, in my view it is equally important that any remedy not be extreme. Microsoft is no longer the most significant threat to innovation on the Internet. Indeed, as I explain more fully below, under at least one understanding of its current Internet strategy, Microsoft could well play a crucial role in assuring a strong and neutral platform for innovation in the future. Thus, rather than retribution, a remedy should aim to steer the company toward this benign and beneficial strategy. Obviously, this benign understanding of Microsoft's current strategy is not the only understanding. Nor do I believe that anyone should simply trust Microsoft to adopt it. But its possibility does suggest the importance of balance in any remedy. The proposed decree does not achieve that balance, but neither, in my view, does the alternative.

I am a law professor at Stanford Law School and have written extensively about the interaction between law and technology. My most recent book addresses directly the effect of law and technology on innovation. I have also been

involved in the proceedings of this case. In 1997, I was appointed special master in the action to enforce the 1995 consent decree. That appointment was vacated by the Court of Appeals when it concluded that the powers granted me exceeded the scope of the special master statute. *United States v. Microsoft Corporation*, 147 F.3d 935, 953-56 (D.C. Cir 1998) ("Microsoft II"). I was then invited by the District Court to submit a brief on the question of using software code to "tie" two products together.<sup>1</sup> I have subsequently spent a great deal of time studying the case and its resolution.

In this testimony, I outline the background against which I draw my conclusions. I then consider the proposed decree, and some of the strengths and weaknesses of the alternative proposed to the District Court by the nine remaining states (the "alternative"). Finally, I consider two particular areas in which this Committee may usefully consider action in light of the experience in this case.

## BACKGROUND

In June, 2001, the Court of Appeals for the D.C. Circuit unanimously affirmed Judge Jackson's conclusion that Microsoft used its power over Windows to protect itself against innovation that threatened its monopoly power. *United States v. Microsoft Corporation*, 253 F.3d 54 (D.C. Cir 2001) (Microsoft III). That behavior, the Court concluded, violated the nation's antitrust laws. The Court therefore ordered the District Court to craft a remedy that would "'unfetter [the] market from anticompetitive conduct,' to 'terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monop-

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<sup>1</sup> See <<http://cyberlaw.stanford.edu/lessig/content/testimony/ab/ab.pdf>>.

lization in the future.” *Microsoft III*, 253 F.2d at 103 (citations omitted).

Integral to the Court’s conclusion was its finding that Microsoft had “commingled code” in such a way as to interfere with the ability of competitors to offer equivalent products on an even playing field. As the District Court found, and the Court of Appeals affirmed, Microsoft had designed its products in such a way as to inhibit the substitution of certain product functionality. This design, the district court concluded, served no legitimate business interest. The Court’s conclusion was therefore that Microsoft had acted strategically to protect its market power against certain forms of competition.

In my view, this holding by the Court of Appeals is both correct and important. It vindicates a crucial principle for the future of innovation generally, and in particular, on the Internet. By affirming the principle that no company with market power may use its power over a platform to protect itself against competition, the Court has assured competitors in this and other fields that the ultimate test of success for their products is not the decision by a platform owner, but the choice of consumers using the product. To the extent that Microsoft’s behavior violated this principle, and continues to violate this principle, it is appropriate for the District Court to craft a remedy that will stop that violation.

An appropriate remedy, however, must take into account the competitive context at the time the remedy is imposed. And in my view, it is crucially important to see that Microsoft does not represent the only, or even the most significant, threat to innovation on the Internet. If the exercise of power over a platform to protect that platform owner from competition is a threat to innovation (as I believe the Court of Appeals has found), then there are other actors who also have significant power over aspects of the Internet platform who could also pose a similarly

dangerous threat to the neutral platform for innovation that the Internet as has been. For example, broadband cable could become a similar threat to innovation, if access to the Internet through cable is architected so as to give cable the power to discriminate among applications and content. Similarly, as Chairman Michael Powell suggested in a recent speech about broadband technology, overly protective intellectual property laws could well present a threat to broadband deployment.<sup>2</sup>

Microsoft could play a significant role in resisting this kind of corruption of the Internet's basic values, and could therefore play an important role in preserving the environment for innovation on the net. In particular, under one understanding of Microsoft's current Internet strategy (which I will refer to generally as the ".NET strategy"), Microsoft's architecture would push computing power and network control to the "edge" or "ends" of the network, and away from the network's core. This is consistent with a founding design principle of the early network — what network architects Jerome Saltzer, David Clark, and David Reed call "the end-to-end argument."<sup>3</sup> .NET's possible support of this principle would compete with pressures that now encourage a compromise of the end-to-end design. To the extent Microsoft's strategy resists that compromise, it could become a crucial force in preserving the innovation of the early network.

This is not to say that this benign, pro-competitive design is the only way that Microsoft could implement its .NET strategy. There are other implementations that could certainly continue Microsoft's present threat to com-

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<sup>2</sup> See <<http://www.fcc.gov/Speeches/Powell/2001/spmcp110.html>> (suggesting "re-examining the copyright laws" and comparing freedom assured by decision permitting VCRs).

<sup>3</sup> See *End to End Arguments in System Design*, <<http://web.mit.edu/Saltzer/www/publications/>>.

petition. And obviously, I am not arguing that anyone should trust Microsoft's representation that it intends one kind of implementation over another. Trust alone is not an adequate remedy to the current antitrust trial.

My point instead is that there is little reason to vilify a company with a strong and powerful interest in a strategy that might well reinforce competition on the Internet — especially when, excepting the open source and free software companies presently competing with Microsoft, few of the other major actors have revealed a similarly pro-Internet strategy. Thus, rather than adopting a remedy that is focused exclusively on the “last war,” a proper remedy to the current antitrust case should be sufficient to steer Microsoft towards its benign strategy, while assuring an adequate response if it fails to follow this pro-competitive lead.

Such a remedy must be strong but also effectively and efficiently enforceable. The fatal weakness in the proposed decree is not so much the extent of the restrictions on Microsoft's behavior, as it is the weaknesses in the proposed mechanisms for enforcement. Fixing that flaw is no doubt necessary to assure an adequate decree. In my view, it may also be sufficient.

### THE PROPOSED DECREE

While the proposed decree is not a model of clarity, the essence of its strategy is simply stated: To use the market to police Microsoft's monopoly. The decree does this by assuring that computer manufacturers and software vendors remain free to bundle and support non-Microsoft software without fear of punishment by Microsoft. Dell or Compaq are thus guaranteed the right to bundle browsers from Netscape or media players from Apple regardless of the mix that Microsoft has built into Windows. Autonomy from Microsoft is thus the essence of the plan — the freedom to include any “middleware” software with an operat-

ing system regardless of whether or not it benefits Microsoft.

If this plan could be made to work, it would be the ideal remedy to this four year struggle. Government regulators can't know what should or should not be in an operating system. The market should make that choice. And if competitors and computer manufacturers could be assured that they can respond to the demands of the market without fear of retaliation by Microsoft, then in my view they would play a sufficient role in checking any misbehavior by Microsoft.

The weakness in the proposed decree, however, is its failure to specify any effective mechanism for assuring that Microsoft complies. The central lesson that regulators should have learned from this case is the inability of the judicial system to respond quickly enough to violations of the law.

Thus the first problem that any proposed decree should have resolved is a more efficient way to assure that Microsoft complies with the decree's requirements. Under the existing system for enforcement, by the time a wrong is adjudicated, the harm of the wrong is complete.

Yet the proposed decree does nothing to address this central problem. The decree does not include provision for a special master, or panel of masters, to assure that disagreements about application could be quickly resolved. Nor does it provide an alternative fast-track enforcement mechanism to guarantee compliance.

Instead the decree envisions the creation of a committee of technical experts, trained in computer programming, who will oversee Microsoft's compliance. But while such expertise is necessary in the ongoing enforcement of the decree, equally important will be the interpretation and application of the decree to facts as they arise. This role cannot be played by technical experts, and yet in my view,

this is the most important role in the ongoing enforcement of the decree.

For example, the decree requires that Microsoft not retaliate against an independent software vendor because that vendor develops or supports products that compete with Microsoft's. Proposed Decree, §III.B. By implication, this means Microsoft would be free to retaliate for other reasons unrelated to the vendor's competing software. Whether a particular act was "retaliation" for an improper purpose is not a technical question. It is an interpretive question calling upon the skills of a lawyer. To resolve that question would therefore require a different set of skills from those held by members of the technical committee.

The remedy for this weakness is a better enforcement mechanism. As the nine remaining states have suggested, a special master with the authority to interpret and apply the decree would assure a rapid and effective check on Microsoft's improper behavior. While I suggest some potential problems with the appointment of a special master in the final section of this testimony, this arrangement would assure effective monitoring of Microsoft, subject to appeal to the District Court.

The failure to include an effective enforcement mechanism is, in my view, the fatal weakness in the proposed decree. And while I agree with the nine remaining states that there are other weaknesses as well, in my view these other weaknesses are less important than this single flaw. More specifically, in my view, were the decree modified to assure an effective enforcement mechanism, then it may well suffice to assure the decree's success. Without this modification, there is little more than faith to assure that this decree will work. With this modification, even an incompletely specified decree may suffice.



The reason, in my view, is that even a partial, yet effectively enforced decree, could be sufficient to steer Microsoft away from strategic behavior harmful to competition. Even if every loophole is not closed, if the decree can be effectively enforced, then it could suffice to push Microsoft towards a benign, pro-competitive strategy. The proposed decree has certainly targeted the most important opportunity for strategic, or anti-competitive, behavior. If the chance to act on these without consequence is removed, then in my view, Microsoft has a strong incentive to focus its future behavior towards an implementation of its .NET strategy that would reinforce rather than weaken the competitive field. An effective, if incomplete, decree could, in other words, suffice to drive Microsoft away from the pattern of strategic behavior that has been proven against it in the Court of Appeals.

There are those who believe Microsoft will adopt this benign strategy whether or not there is a remedy imposed against them. Indeed, some within Microsoft apparently believe that supporting a neutral open platform is in the best interests of the company.<sup>4</sup> Given the significant findings of liability affirmed by the Court of Appeals, I do not believe it is appropriate to leave these matters to faith. But I do believe that a remedy can tilt Microsoft towards this better strategy, at least if the remedy can be efficiently enforced.

### THE NINE STATES' ALTERNATIVE

On Friday, December 7, 2001, the nine states that have not agreed to the proposed consent decree outlined an alternative remedy to the one proposed by the Justice Department. In many ways, I believe this alternative is superior to the Justice Department's proposed decree. This al-

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<sup>4</sup> This is the argument of David Bank's *Breaking Windows: How Bill Gates Fumbled the Future of Microsoft* (New York: Free Press, 2001).

ternative more effectively protects against a core strategy attacked in the District Court — the commingling of code designed to protect Microsoft's monopoly power. It has an effective enforcement provision, envisioning the appointment of a special master. The alternative has a much stronger mechanism for adding competition to the market — by requiring that Microsoft continue to market older versions of its operating system in competition with new versions. And finally, the alternative requires that Microsoft continue to distribute Java technologies as it has in prior Windows versions.

The alternative, however, goes beyond what in my view is necessary. And while in light of the past, erring on the side of overly protective remedies might make sense, I will describe a few areas where the alternative may have gone too far, after a brief description of a few of the differences that I believe are genuine improvements.

#### *Areas of Common Strategy*

Both the proposed decree and the alternative agree on a common set of strategies for restoring competition in the market place. Both seek to assure autonomy for computer manufacturers and software vendors to bundle products on the Microsoft platform differently according to consumer demand. Both decrees aim at that end by guaranteeing nondiscriminatory licensing practices, and restrictions on retaliation against providers who bundle or support non-Microsoft products. The alternative specifies this strategy more cleanly than the proposed decree. It is also more comprehensive. But both are aiming rightly at the same common end: to empower competitors to check Microsoft's power.

#### *Improvements of the Alternative*

The alternative remedy adds features to the proposed decree that are in my view beneficial. Central among these is the more effective enforcement mechanism. The alter-

native proposes the establishment of a special master, with sufficient authority to oversee compliance. This, as I've indicated, is a necessary condition of any successful decree, and may also be sufficient.

Beyond this significant change, however, there are a number of valuable additions in the states' alternative. By targeting the "binding" of middleware to the operating system, the alternative more effectively addresses a primary concern of the Court of Appeals. This restriction assures that Microsoft does not architect its software in a way that enables it strategically to protect itself against competition. Such binding was found by the courts to make it costly for users to select competing functionality, without any compensating pro-competitive benefit.

The alternative also assures much greater competition with new versions of the Windows operating system by requiring that prior versions continue to be licensed by Microsoft. This competition would make it harder for Microsoft to use its monopoly power to push users to adopt new versions of the operating system that advance Microsoft's strategic objectives, but not consumer preferences.

Finally, the alternative addresses a troubling decision by Microsoft to refuse to distribute Java technologies with Windows XP. This decision by Microsoft raises a significant concern that Microsoft is determined to continue to play strategically to strengthen the applications barrier to entry.

*Concerns about the proposed alternative*

While I believe the alternative represents a significant improvement over the proposed consent decree, I am concerned that the alternative may go beyond the proper scope of the remedy.

*Open Sourcing Internet Explorer:* While I am a strong supporter of the free and open source software movements,

and believe software of both varieties is unlikely ever to pose any of the same strategic threats that closed source software does, I am not convinced the requirement of open sourcing Internet Explorer is yet required, or even effective. Both proposed remedies have a strong requirement that application interfaces be disclosed, and until that remedy proves incomplete, I don't believe the much more extreme requirement of full disclosure of source code is merited.

*The definition of Middleware Products:* The central target of the litigation was Microsoft's behavior with respect to middleware software. Understood in terms relevant to this case, middleware software is software that lowers the applications barrier to entry *by reducing the cost of cross-platform compatibility*. Java tied to the Netscape browser is an example of middleware so understood; had it been successfully and adequately deployed, it would have made it easier for application program developers to develop applications that were operating system agnostic, and therefore would have increased the demand for other competing operating systems.

This definition is consistent with the alternative definition of "middleware." But the specification of "middleware products" reaches, in my view, beyond the target of "middleware." Middleware is not properly understood as software that increases the number of cross-platform applications; middleware is software that increases the ease with which cross-platform programs can be written. Thus, for example, Office is not middleware simply because it is a cross-platform program. It would only qualify as middleware if it made it easier for programmers to write platform-agnostic code.

*The requirement that Office be ported:* For a similar reason, I am not convinced of the propriety of requiring that Office be ported. While Office for the Macintosh is certainly a crucial application for the continued viability of the Macintosh OS, having Office on many platforms does

not significantly affect the applications barrier to entry. No doubt if Microsoft strategically pulled the development of Office in order to defeat another operating system, or if it aggressively resisted applications that were designed to be compatible with Office (such as Sun's Star Office), that could raise antitrust concerns. But the failure simply to develop office for another platform would not itself respond to the concerns of the Court of Appeals.

No doubt, each of these additional remedies might be conceived of as necessary prophylactics given a judgment that Microsoft is resolved to continue its strategic anticompetitive behavior. And after a fair and adequate hearing in the District Court, such a prophylactic may well prove justified. At this stage, however, I am not convinced these have been proven necessary.

#### APPROPRIATE CONGRESSIONAL ACTION

It is obviously inappropriate for Congress to intervene in an ongoing legal dispute with the intent to alter the ultimate judgment of the judicial process. Thus while I believe it is extremely helpful and important that this Committee review the matters at stake at this time, there is a limit to what this Committee can properly do. In a system of separated powers, Congress does not sit in judgment over decisions by Courts.

Yet there are two aspects to this case that do justify a greater concern by Congress. Both aspects are intimately tied to earlier decisions by the Court of Appeals. First, in light of the Court of Appeals' judgment in the 1995 Microsoft litigation, *United States v. Microsoft Corporation*, 56 F.3d 1448 (D.C. Cir. 1995) (Microsoft I), it is clear that the Tunney Act proceedings before the District Court are extraordinarily narrow. Second, in light of the Court of Appeals' judgment in 1998 Microsoft litigation, *Microsoft II*, it is not clear that, absent consent of the parties, the District Court has the power to appoint a special master with

the necessary authority to assure enforcement of any proposed remedy. Both concerns may justify this Committee taking an especially active role to assure a proper judgment can be reached — in the first case through its consultation with the executive, and the second, possibly with clearer legislative authority.

*The Tunney Act Proceedings*

In *Microsoft I*, the Court of Appeals for the D.C. Circuit held that the District Court's authority under the Tunney Act to question a consent decree proposed by the government was exceptionally narrow. Though that statute requires that the District Court assure that any consent decree is "within the public interest," the Court read that standard to be extremely narrow. If the decree can be said to be within "the reaches of the public interest," *Microsoft I*, 56 F.3d at 1461, then it is to be upheld.

The consequence of this holding is that it will be especially hard for the District Court to question the government's proposed decree. Absent a showing of corruption, the decree must be affirmed. It is hard for me to imagine that the proposed decree would fail this extremely deferential standard. Thus any weaknesses in the proposed decree would have to be resolved in the parallel proceedings being pursued by the nine states.

This deference may be a reason for Congress in the future to revisit the standard under the Tunney Act. Such a review could not properly affect this case, but concerns about this case may well suggest the value in future contexts.

But the concern about this decree may well be relevant to this Committee's view about the appropriateness of the government's cooperation with any ongoing prosecution by the nine states. The federal government may well have decided its remedy is enough; it wouldn't follow from that determination that the federal government has a reason to

oppose the stronger remedies sought by the states. At a minimum, the government should free advisors or consultants it has worked with to aid the continuing states as they may desire.

*The power to appoint a "special master"*

In *Microsoft II*, the Court of Appeals interpreted a District Court's power to appoint a special master quite narrowly. While the Court acknowledged the strong tradition of using special masters to enforce judgments, it raised doubt about the power of the special master to act beyond essentially ministerial tasks. In particular, the task of interpreting and applying a consent decree to contested facts was held by the Court of Appeals to be beyond the statute's power — at least where the District Court did not reserve to itself de novo review of the special master's determination. *Microsoft II*, 147 F.3d at 953-56.

This narrow view of a special master's power was a surprise to many. It may well interfere with the ability of District Courts to utilize masters in highly technical or complex cases. This Committee may well need to consider whether more expansive authority should be granted the District Courts. Especially in the context of highly technical cases, a properly appointed master can provide invaluable assistance to the District Court judge.

These limitations would not, of course, restrict the appointment of a master in any case to which the parties agreed. And it may well be that the simplest way for Microsoft to achieve credibility in the context of this case would be for it to agree to the appointment of a master with substantial authority to interpret and apply the decree, subject to de novo review by the District Court. Such a master should be well trained in the law, but also possess a significant degree of technical knowledge. But beyond the particulars of this case, it may well be better if the District Court had greater power to call upon such as-

sistance if such the Court deemed such assistance necessary.





**Consumer Federation of America**

**STATEMENT OF  
DR. MARK N. COOPER**

**On**

**THE MICROSOFT SETTLEMENT:  
A LOOK TO THE FUTURE**

**Before the  
COMMITTEE ON THE JUDICIARY  
UNITED STATES SENATE**

**December 12, 2001**

**Mr. Chairman and Members of the Committee,**

My name is Dr. Mark Cooper. I am Director of Research of the Consumer Federation of America. The Consumer Federation of America is the nation's largest consumer advocacy group, composed of two hundred and seventy state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, with more than fifty million individual members.

I greatly appreciate the opportunity to appear before you today. This hearing on "The Microsoft Settlement: A Look To the Future" focuses public policy attention on exactly the right questions. What should the software market look like? Does the Court of Appeals' ruling provide an adequate legal foundation for creating that market? Is it worth the effort? What specific remedies are necessary to get the job done?

Our analysis of the Microsoft case over four years leads us to clear answers.<sup>1</sup>

- We reject the claim that consumers must accept monopoly in the software industry. Real competition can work in the software market, but it will never get a chance if Microsoft is not forced to abandon the pervasive pattern of anticompetitive practices it has used to dominate product line after product line.
- The antitrust case has revealed a massive violation of the antitrust laws. A unanimous decision of the Appeals Court points the way to restoring competition.
- The public interest demands that we try.
- The proposed Microsoft-Department of Justice settlement is far too weak to accomplish that goal. The litigating states' remedial proposals are now the only chance that consumers have of enjoying the benefits of competition in the industry.

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<sup>1</sup> *The Consumer Case Against Microsoft* (October 1998); *The Consumer Cost of the Microsoft Monopoly: \$10 Billion and Counting* (January 1999); *Economic Evidence in the Antitrust Trial: The Microsoft Defense Stumbles Over the Facts* (March 18, 1999); *Facts Law and Antitrust Remedies: Time for Microsoft to be Held Accountable for its Monopoly Abuses* (May 2000) (Attachment A); Mark Cooper, "Antitrust as Consumer Protection in the New Economy: Lessons from the Microsoft Case," *Hastings Law Journal*, 52 (April 2001) (see Attachment B); *Windows XP/.NET: Microsoft's Expanding Monopoly, How it Can Harm Consumers and What the Courts Must Do to Preserve Competition* (September 26, 2001) (see Attachment C).

## Real Competition In The Software Industry Is The Goal

The defenders of the Microsoft monopoly say that consumers cannot hope for competition within software markets because this is a winner-take-all, new economy industry. In this product space companies always win the whole market or most of it, so anything goes. In fact, Microsoft's expert witness has written in a scholarly journal that:

With "winner take most" markets... [If] there can be only one healthy survivor, the incumbent market leader must exclude its competition or die... There is no useful non-exclusion baseline, which the traditional test for predation requires...

As to intent, in a struggle for survival that will have only one winner, any firm must exclude rivals to survive.... In a winner take most market, evidence that A intends to kill B merely confirms A's desire to survive.<sup>2</sup>

By that standard, if a monopolist burned down the facilities of a potential competitor, it might be guilty of arson and other civil crimes, but it would not be guilty of violating the antitrust laws. Consumers should be thankful that both the trial court and the Appeals Court flatly rejected this theory of the inevitability of monopoly and upheld the century old standard of competition.

In fact, the products against which Microsoft has directed its most violent anticompetitive attacks represent the best form of traditional competition – compatible products that operate on top of existing platforms seeking to gain market share by enhancing functionality and expanding consumer choice.<sup>3</sup> Microsoft fears these products and seeks to destroy them, not compete against them, precisely because they represent uncontrolled compatibility, rampant interoperability and, over the long-term, potential alternatives to the Windows operating system.

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<sup>2</sup> Richard Schmalensee, "Antitrust Issues in Schumpeterian Industries," 90 *American Economic Review* 192-194 (2000).

<sup>3</sup> Mark Cooper, *Antitrust and Consumer Protection*, pp. 863-880.



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<sup>1</sup> *The Consumer Case Against Microsoft* (October 1998); *The Consumer Cost of the Microsoft Monopoly: \$10 Billion and Counting* (January 1999); *Economic Evidence in the Antitrust Trial: The Microsoft Defense Stumbles Over the Facts* (March 18, 1999); *Facts Law and Antitrust Remedies: Time for Microsoft to be Held Accountable for its Monopoly Abuses* (May 2000) (Attachment A); Mark Cooper, "Antitrust as Consumer Protection in the New Economy: Lessons from the Microsoft Case," *Hasting Law Journal*, 52 (April 2001) (see Attachment B); *Windows XP/.NET: Microsoft's Expanding Monopoly, How it Can Harm Consumers and What the Courts Must Do to Preserve Competition* (September 26, 2001) (see Attachment C).

## Real Competition In The Software Industry Is The Goal

The defenders of the Microsoft monopoly say that consumers cannot hope for competition within software markets because this is a winner-take-all, new economy industry. In this product space companies always win the whole market or most of it, so anything goes. In fact, Microsoft's expert witness has written in a scholarly journal that:

With "winner take most" markets... [If] there can be only one healthy survivor, the incumbent market leader must exclude its competition or die... There is no useful non-exclusion baseline, which the traditional test for predation requires...

As to intent, in a struggle for survival that will have only one winner, any firm must exclude rivals to survive.... In a winner take most market, evidence that A intends to kill B merely confirms A's desire to survive.<sup>2</sup>

By that standard, if a monopolist burned down the facilities of a potential competitor, it might be guilty of arson and other civil crimes, but it would not be guilty of violating the antitrust laws. Consumers should be thankful that both the trial court and the Appeals Court flatly rejected this theory of the inevitability of monopoly and upheld the century old standard of competition.

In fact, the products against which Microsoft has directed its most violent anticompetitive attacks represent the best form of traditional competition – compatible products that operate on top of existing platforms seeking to gain market share by enhancing functionality and expanding consumer choice.<sup>3</sup> Microsoft fears these products and seeks to destroy them, not compete against them, precisely because they represent uncontrolled compatibility, rampant interoperability and, over the long-term, potential alternatives to the Windows operating system.

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<sup>2</sup> Richard Schmalensee, "Antitrust Issues in Schumpeterian Industries," 90 *American Economic Review* 192-194 (2000).

<sup>3</sup> Mark Cooper, *Antitrust and Consumer Protection*, pp. 863-880.

EMBARGOED UNTIL 10:00 AM, WEDNESDAY, DECEMBER 12, 2001

**Association** for  
Competitive Technology

TESTIMONY OF MR. JONATHAN ZUCK

PRESIDENT

ASSOCIATION FOR COMPETITIVE TECHNOLOGY (ACT)

BEFORE THE

JUDICIARY COMMITTEE

UNITED STATES SENATE

WEDNESDAY, DECEMBER 12, 2001

160 DIRKSEN SENATE OFFICE BUILDING

WASHINGTON, DC 20510

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## INTRODUCTION

Good morning, Mr. Chairman and members of the Committee. I am Jonathan Zuck, President of the Association for Competitive Technology, or ACT. On behalf of our member companies, it is my sincere honor to testify before this committee today. As a professional software developer and technology educator, I am grateful for this opportunity and appreciate greatly your interest in learning more about the effects of the proposed settlement entered into by the United States Department of Justice (DOJ), nine state attorneys general and Microsoft on our industry. ACT is a national, Information Technology (IT) industry group, founded by entrepreneurs and representing the full spectrum of technology firms. Our members include household names such as Microsoft, e-Bay and Orbitz. However, the vast majority of our members are small and midsize business, including software developers, IT trainers, technology consultants, dot-coms, integrators and hardware developers located in your states. The majority of ACT members cannot hire lawyers and lobbyists or fly to Washington to have their views heard. Therefore, they look to ACT to represent their interests. To be sure, to meet the needs of our broad constituency, we don't always agree with our members, even Microsoft, on some policy issues.

I have a great deal of respect and sympathy for the plight of these small technology companies, because I spent over fifteen years running similar companies. During this time, I've managed as many as 300 developers, taught over a hundred classes, and worked on some interesting projects. I was responsible for a loan evaluation application for Freddie Mac, an automated Fitness Report application for the Navy and a Regional



Check Authentication system for the Department of Treasury. I have built software on multiple platforms include DOS, DR-DOS, OS/2 and Windows using tools from many vendors including Microsoft, Oracle, Sybase, Powersoft, IBM, Borland and others. I remain active as a technologist and last year designed a system to get to your corporate data wirelessly. I have also delivered keynotes and other presentations at technical conferences around the world.

While ACT members vary in their size and businesses, they share a common desire to maintain the competitive character of today's vibrant technology sector that has been responsible for America's "new economy." Unfortunately, for the last three years, the tens of thousands of small businesses in the IT industry have been virtually ignored during the government's investigation and prosecution of Microsoft.

I believe the settlement, on balance, is good not only for the bulk of the IT industry, but for consumers as well. Voters also see the value in the settlement. Voter Consumer Research conducted polls of 1,000 eligible voters last month in Utah and Kansas that are quite telling. In Utah and Kansas, when asked if their state attorney general should pursue the case after the DOJ settlement had been reached, the respondents said, *by a 6 to 1 margin*, that they should not.

As one of the "techies" on this panel, I look forward to getting into more "real life" effects of the proposed settlement to prove this point.

With that backdrop, my testimony today is focused on describing how the settlement will foster competition for thousands of America's small IT companies and how that, in turn, will benefit consumers.

## THE STATE OF OUR INDUSTRY

Before we discuss life in a post Microsoft settlement world, I must speak to present-day competition and innovation. I want to begin by stating *unequivocally* that, counter to the protestations of some "experts," competition in the IT industry is alive and well. One demonstrable example is amount of capital investment by Venture Capitalists (VCs) and where that money is headed. Despite the recent downturn, VCs are still looking for the next "billion dollar deal." I know because I have worked with many of them. I won't get into the negative impact this "homerun or nothing" strategy has had on our industry but suffice it to say, billion dollar deals do not come from investing in mature markets with limited growth potential and large existing players. Billion dollar deals only come from investing in new markets with unlimited growth potential and those do not include office productivity software market or even the general PC software market. Indeed, a recent survey of VC's conducted by the DEMOletter, showed that nearly a third of those surveyed will invest over \$100 million in start-ups in 2002 and that nearly 20 per cent are planning to invest up to \$250 million.<sup>1</sup> The sectors of the IT industry receiving this money include software and digital media.<sup>2</sup> These are precisely the sectors that would

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<sup>1</sup> DEMOletter, December 2001, at 5-6.

<sup>2</sup> Id., at 5.

benefit from this settlement. Suggestions that opposing the settlement would encourage VC's to change their stripes are ridiculous.

In fact, the information technology world is experiencing a shift away from desktop computing and toward other devices such as personal digital assistants (PDA's), cell phones, set top boxes/game consoles, web terminals and powerful servers that connect them all. In all these growth markets, competition is very strong even though Microsoft is present. As of the third quarter of this year, more than 52 percent of all PDA's were shipped with the Palm operating system while only 18 percent carried a Microsoft operating system according to Gartner. With cell phone manufacturers rushing to integrate PDA functionality, there are several large players including Symbian (a joint venture between Nokia, Motorola, Ericsson, Matsushita [Panasonic], and Psion), Palm, Linux and Research in Motion's Blackberry operating system. In the game console/set-top box arenas, Microsoft is just entering the picture with established companies like Sony and Nintendo standing on large installed user bases.

The server market is probably the best example of this growing competition. According to IDC, Linux's worldwide market share of new and upgraded operating systems for servers was 27 percent in 2000. It was second only to Microsoft, which stood at 42 percent. IDC predicts Linux's market share will expand to 41 percent by 2005, while Microsoft's will only grow to 46 percent. Things should only become more competitive with IBM putting a billion dollars into its Linux push this year. The vigorous

competition in this space proves in the absence of government intervention, companies like Linux can thrive.

## BENEFITS OF THE SETTLEMENT

As the members of the Committee are doubtlessly aware, on November 2, 2001 the DOJ and Microsoft tentatively agreed on a settlement (or consent decree) designed to end the federal antitrust suit. Soon thereafter, nine states attorneys general signed off on a revised settlement. The proposed settlement succeeds in striking a difficult compromise between the “drastically altered” finding of liability adopted by the Court of Appeals and the wishes of Microsoft competitors and critics for crippling sanctions against the company.<sup>3</sup> Remarkably, the negotiators have worked out a settlement proposal that, while entirely satisfying to none, includes something for everyone.

A number of Microsoft competitors and their advocates have suggested that this agreement is flawed in that it “does not prevent Microsoft from leveraging its monopoly into other markets.” This argument is based on an unfounded fear that Microsoft will attempt to monopolize other markets such as instant messaging and digital media. Undermining this argument is the fact that the Court of Appeals found unanimously that Microsoft did not use its monopoly in the browser (or middleware) market.<sup>4</sup> The bottom line is that the settlement was focused on addressing the allegedly anticompetitive conduct of the past and preventing similar conduct in the future. It is entirely consistent

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<sup>3</sup> *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001) at 102.

<sup>4</sup> The Court of Appeals noted “Because plaintiffs have not carried their burden on either

with the basic tenet of antitrust law, which is to protect consumers and competition, not competitors.

With that understanding, it is important to address the benefits the industry and consumer will derive from implementation of the proposed settlement. ACT believes that the benefits of the settlement can be classified as follows:

1. Increased flexibility for Original Equipment Manufacturers (OEMs)
2. Increased flexibility for third party IT companies
3. Greater consumer choice
4. Effective enforcement

I will discuss each benefit in turn, paying particular attention to the positive effects on competition in our industry.

1. Increased flexibility for Original Equipment Manufacturers (OEMs)

OEMs play a pivotal role in “supply chain” of delivering a rich computing experience for consumers. They provide independent software vendors (ISVs), many of whom are small IT companies, a valuable conduit by which to sell their wares directly to consumers by vying for space on the computer desktop. Thus, it is critical that OEMs have the flexibility to meet market demands by negotiating with ISVs for this type of placement. This practice is known as “monetizing the desktop” and is consistent with market-based competition. Under the proposed

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prong, [of an attempted monopolization analysis] we reverse without remand.” *Id.* , at 63.

settlement, OEMs will have the flexibility to develop, distribute, use, sell, or license any software that competes with Windows or Microsoft “middleware”<sup>5</sup> without restrictions or any kind of retaliation from Microsoft.<sup>6</sup> Reinforcing this flexibility, the settlement prohibits Microsoft from even entering into agreements that obligate OEMs to any exclusive or fixed-percentage arrangements.<sup>7</sup> This allows OEMs to negotiate with an array of ISVs through the use of any number of incentives. Moreover, OEMs obtain some control over the desktop space for such things as icons and shortcuts.<sup>8</sup> Another critical element allowing the OEMs to create a competitive playing field is that they have the ability to have non-Microsoft operating systems (e.g., Linux) and other Internet Access Providers (IAP) offerings (e.g., alternative Internet connections such as AOL) launch at boot-up.<sup>9</sup>

## 2. Increased flexibility for third party IT companies

Like OEMs, ISVs and Independent Hardware Vendors (IHVs) gain the flexibility to develop, distribute, use, sell, or license any software that competes with Windows or Microsoft middleware without restrictions or any kind of retaliation from Microsoft.<sup>10</sup> The importance of this fact cannot be overstated. ISVs and

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<sup>5</sup> “Microsoft Middleware Product” is a defined term, while inconsistent with common industry usage, has the meaning of “the functionality provided by Internet Explorer, Microsoft’s Java Virtual Machine, Windows Media Player, Windows Messenger, Outlook Express and their successors in a Windows Operating System Product.” Revised Proposed Final Judgment, Section VI.K.

<sup>6</sup>Id., Section III.A.

<sup>7</sup> Id., Section III.G.

<sup>8</sup> Id., Section III.C.

<sup>9</sup> Id., Section III.C.

<sup>10</sup> Id., Section III.F.

IHVs, especially the thousands of small and mid-size companies in these categories, make up a bulk of the IT industry and will be able to utilize this flexibility to innovate and deliver “consumer critical” products such as instant messaging and digital media to consumers.

The ISVs and IHVs will obtain *advance* disclosure of Windows APIs, communications protocols, which will increase the quantity and quality of competitive product offerings.<sup>11</sup> As with OEMs, Microsoft will be barred from thwarting competition by entering into agreements that obligate ISVs, IHVs, IAPs, or ICPs to any exclusive or fixed-percentage arrangements.<sup>12</sup> It should be noted that the settlement restricts some freedoms in crafting contracts with Microsoft, and thus may discourage some companies that might otherwise like to sign on to “dance” with Microsoft. However, it also protects other companies from any efforts by Microsoft to prevent them from teaming up with Microsoft’s competitors like Sun Microsystems or AOL.

### 3. Greater consumer choice

Nothing is as important to our industry as giving consumers, or end users, the freedom to choose what products and services they want or need. To this end, the settlement ensures that consumers will have the ability to enable or remove access to Microsoft or non-Microsoft middleware, or substitute a non-Microsoft

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<sup>11</sup> Id., Sections III.D., III.E.

<sup>12</sup> Id., Sections III.G., III.F

middleware product for a Microsoft middleware product.<sup>13</sup> Microsoft's detractors have generated much commotion with the notion that removal of icons or "automatic invocations" is not enough, and that to give consumers "real" choice, underlying code would have to be removed. This is nonsensical for two reasons. First, it is a known fact that removal of visible access (e.g., an icon) to middleware or an application is a very effective means of getting the end user to forget about it. Think about how many icons reside on the average user's desktop that serve to "remind" him of what product to use for a certain task. It is a simple case of "out of sight, out of mind." Second, it is also a known fact that removal of the underlying does nothing to enhance consumer choice, and actually could destabilize the platform, increasing costs to consumer software developers who could no longer count on programming interfaces within the Windows operating system. The net result of these provisions is that consumers will be in the position to pick the products *they* consider to best meet their needs – whether it be downloading music, sharing pictures over the Web, or chatting with friends via instant messaging applications.

Another myth propagated by Microsoft's competitors is that Microsoft gets to reset the desktop to its preferred configuration 14 days after the consumer buys it no matter what steps the OEM or the consumer have actually taken to try to exercise the choice to use a non-Microsoft product. This is absolutely false. The desktop would not be reset and consumers will always retain choice. For

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<sup>13</sup> Id. III.H.



example, consumers can choose among the OEM's configuration, their own configuration and Microsoft's configuration.

#### 4. Effective Enforcement

The final element of the settlement that will ensure competition is the enforcement provisions. Microsoft must license its intellectual property to the extent necessary for OEMs and other IT companies to exercise any of the flexibility provided in the agreement.<sup>14</sup> In an unprecedented move, the decree creates a jointly appointed Technical Committee (TC) to monitor compliance.<sup>15</sup> The TC will have three members and unspecified staff, and be granted unfettered access to Microsoft staff and documents. While the TC is a better enforcement mechanism than having to apply to a court for each software design element, it is not without some flaws. For example, there are no restrictions on how the TC can be utilized as a tool by Microsoft's competitors to delay shipment of an operating system or middleware product. While this may cause Microsoft some heartburn if it is used for such delay, it will be a fatal malady to the thousands of small and mid-size ISVs, IHVs, training firms and consultants that depend on a timely product launch. I am not a lawyer, so I can only propose a practical solution to this problem. Perhaps the competitors (or anyone else with the view that Microsoft is not complying with the consent decree) should be required to bring

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<sup>14</sup> Id., Section III.I.

<sup>15</sup> Id., Section IV.B.

their problems to the TC at specified times during the development life cycle. This would prevent “last minute” delays.

Finally, Microsoft is required to implement an internal Compliance Officer to be responsible for handling complaints and compliance issues.<sup>16</sup> This is yet another safeguard that aggrieved parties can use to ensure Microsoft’s compliance with the consent decree.

Unfortunately these provisions are not enough to satiate some bent on seeing that this settlement never gets approved. For example, they question why the settlement lasts for only 5 years rather than the customary 10. This inquiry fails to acknowledge the realities of the IT industry and the speed at which we innovate. One need only think about the number and types of products that have emerged since 1998 to see why applying static conduct restrictions are out of step with our industry and provide no added value. Further, I believe seeking extended application of the settlement only exposes a bias against Microsoft

Because of the significant impact on our industry, I must also address the additional remedies proposed by the nine state attorneys general who did not sign the consent decree. While their aim to “restore competition” is a valid and important antitrust principle – as long as it is limited to the elimination of competitive barriers – their proposal ignores the Court of Appeals ruling and runs counter to established antitrust jurisprudence. The DOJ settlement agreement was wise to avoid the dangerous

temptation to redesign and regulate market outcomes. I'll point out two defects of the state's proposal. First, requiring that Windows "must carry" Java does *nothing* for consumers who can download it with one click and only serves to thwart competition by giving Sun Microsystems a special government-mandated monopoly with which other middleware companies will have to compete. While I believe "must-carry" provisions are inherently anticompetitive, if the attorneys general were really trying to stand on principle they would have to ask for the same provisions for other middleware providers as well. Second, requiring Microsoft to port its Office product to Linux is tantamount to making it a "ward of the state." There are already several office productivity suites available to users of Linux and some are even free. It would stand to reason that if attorneys general are actually interested in removing any "applications barrier to entry" that may exist, they should force the developers of ALL popular software products to port them to Linux. It is clear that from the extreme nature of these proposals that the settlement must encompass all reasonable mechanisms to restore competition. The respondents to the Voter Consumer Research polls mentioned above also question the need for the far-reaching remedies that would hamper Microsoft's ability to innovate. In Utah for example, nearly 70% of voters believe that Microsoft's products have helped consumers and over 80% of these voters feel that that Microsoft has benefited the computer industry. These numbers beg the question: Where's the harm that would justify the nine state's harsh remedies.

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<sup>16</sup> Id., Section IV.C.

## Conclusion

For ACT member companies, the IT industry and for me, it has been a very long three and a half years. This settlement reflects a balanced resolution to this litigation and a welcome end to the uncertainty that has hung over our industry at a time when certainty is what we need most. It addresses the anticompetitive actions articulated by a unanimous Court of Appeals. I believe Assistant Attorney Charles James when he said "This settlement . . . has the advantages of immediacy and certainty."<sup>17</sup> It my sincere hope that the District Court will approve the settlement at the conclusion of the public comment period. There is no doubt in my mind that it is in the public interest to do so.

Again, I thank the Committee for the opportunity to include the views of ACT's member companies at this important hearing.

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<sup>17</sup> Remarks of Assistant Attorney Charles James, Department of Justice press conference, November 2, 2001.

**Testimony of Matthew J. Szulik**  
**President and CEO**  
**Red Hat, Inc.**  
**to the Judiciary Committee of the United States Senate**  
**December 12, 2001**

Good morning.

I would like to thank the members of the committee for allowing me to contribute my views on a topic that I feel is of vital importance to the future of our nation. I stand before you today as Winston Churchill said, "only to fight while there is a chance, so we don't have to fight when there is none." Through your actions, members of the committee can affect a remedy that many members of the growing, global technical community hope will restore balance and inspire competitiveness in a networked society free of monopolistic practices.

I stand before you today as a representative of the open source community. And as the CEO of Red Hat, Inc., generally regarded as the most successful company that sells and supports open source software. The Red Hat Linux operating system software we sell is created by a global community of volunteers. Volunteers who share their creation of intellectual property. The basis for their work is an open license that requires improvements to the technology be shared with others. Programmers submit their software code, their creations to the scrutiny of a very critical community of peers. The best code wins and is included in the next version of the software. This open communication strikes me as so perfectly American. I envision the early leaders of this country drawing up the tenets of our constitution in much the same way--in the open, in pursuit of a solution that is fair and of benefit to all.

Some have called this the technology equivalent of a barn-raising. Through this approach Linux software has grown, improved and become one of the most stable, cost-effective operating systems in the world. It continues to improve every day.

The values and practices of Red Hat are in most ways antithetical to those of the monopolist I am here to reference.

Much testimony has been provided on the practices by the monopolist, which in my view have placed a technical and financial stranglehold on the technology industry. Mr. McNealy and Mr. Barksdale and others that have come before me have done a good job of presenting the issues to the committee. I support their conclusions that the software industry needs government intervention. I support their requests for strong enforcement of antitrust laws.

I would like to reaffirm their case, that innovation will occur when there is a competitive environment free of monopolistic practices.

Open source software arose because of a lack of alternatives that allowed the individual to choose the best tool for the job. Over the past 5 years, projects created by Red Hat and the open source community have become solutions of choice in areas of standards-based Internet software development, areas that the monopolist does not yet control.

The growth of the Linux operating system is an example of this acceptance. The Apache web

server is another, it now holds a market-leading position.

However, the Internet browser, desktop operating system and office productivity software are areas that have continued to be influenced by one vendor alone.

One of the reasons I am so deeply troubled by the consent decree in this case is that it seems to run counter to things that are fundamental to our identity as Americans. We value fair play, ethical competition, abiding by the rules and fostering innovation. The consent decree throws all of this away. It acknowledges that my competitor has broken the law; that through these violations it has built one of the most formidable businesses in the world. Yet the consent decree does little to prevent future misconduct. I feel if the antitrust laws are not enforced, the will and spirit of the true innovators will suffer.

Lengthy legal critiques of the consent decree are already on record. In the interest of time I will not subject you to more this morning. I am sure you've heard enough legal arguments in considering this topic. Rather, I want to make a few key points:

First, their growing monopoly power has seriously warped the technology market. Now that my competitor is a convicted monopolist, the world can see in the public record what those in technology companies have known for years: they don't compete fairly, they use their dominance in one market to dominate others, and they stifle innovation in the name of competition. The only way to stop this - to restore fairness to the market - is a settlement of this case that denies the monopolist the fruits of its past actions and provides remedial measures on the monopolist for its violations of the law.

Second, the consent decree as it stands today, falls far short of this requirement. Given the monopolist's history of skating up to the edge, or over the edge, in not fully complying with prior settlements, it will take very strong measures to change their behavior. In the words of Massachusetts Attorney General Thomas F. Reilly, commenting on the consent decree: "Five minutes after any agreement is signed with Microsoft, they'll be thinking of how to violate the agreement. They're predators. They crush their competition. They crush new ideas. They stifle innovation. That's what they do."

Microsoft is deeply concerned about open source software and has already making overtures on how it will use dominance rather than technical expertise to crush it.

The CEO of the monopolist said, quote, "Linux is a cancer that attaches itself in an intellectual property sense to everything it touches."

The head of the monopolist's Windows Platform Group has similar beliefs: He said publicly, quote, "Open source is an intellectual property destroyer. I can't imagine something that could be worse than this for the software business." He goes on further to say, "I'm an American, I believe in the American way. I worry if the government encourages open source, and I don't think we've done enough education of policy-makers to understand the threat."

In my view, the consent decree should create a level playing field between Windows and Linux. Because of their comments, and their past actions, I believe the current consent decree is not strong enough. They will circumvent it.

Third, we have all heard of the Digital Divide. It's the gap in information and computing access

between the haves and have nots in our society. As many states struggle with declining revenues, I believe these shortfalls will have a material impact on the public funding of K-12 and higher education. The path to the development of an information economy can not be limited to a sole supplier, who in my view has seen education up to this point, relative to its financial position as a market - not as a responsibility. I believe the lack of choices and high recurring costs is in part responsible for this growing chasm between the two Americas.

I'm involved with North Carolina Central University - an historically black university that cannot afford the monopolist's restrictive licenses and forced upgrades. I see this sad experience in schools throughout our country. Walk the halls of schools in East Roxbury, MA or Snow Hill, NC and question how we can expect, as a nation, to improve the future for our youth when schools must allocate 30-40% of their IT budget for software and hardware upgrades. Provided choice, these same dollars could be put into teacher training and acquiring more technology.

The Chinese government understands this. The French and German governments as well. They have stated that proprietary software will not be used to develop government and educational infrastructure.

But the monopolist has more than 90% of the desktop operating system market and more than 70% of the Internet browser market. What choices do our schools have? What choices do our citizens have? As the monopolist extends its monopoly into additional markets, largely unfettered by the legal system and apparently immune to the consequences of their actions - the Digital Divide widens.

Biologists know that an unbalanced ecosystem, one dominated by a single species, is more vulnerable to collapse. I think we're seeing this today. Under the consent decree, it will continue and probably get worse.

In America, history has taught us that there is no mechanism more logical and efficient and than a free and open market. Our competitor's illegal monopolistic actions have significantly reduced the open market in information technology. I believe that in extreme cases like this, it is the role of the government to step in and restore balance.

Thank you.

**Testimony of**  
**Mitchell E. Kertzman**  
**Chief Executive Officer**  
**Liberate Technologies**

**before the**

**United States Senate**  
**Committee on the Judiciary**

**Wednesday, December 12, 2001**



## **Introduction**

Mr. Chairman, Senator Hatch, and other members of the Committee, thank you for the chance to speak on this critical topic. The Proposed Final Judgment is woefully inadequate. It is a backward-looking document that fails to prevent Microsoft from abusing its monopoly position to increase costs and stifle new technologies -- not just for personal computers, but also for new technologies like digital televisions, cellular phones, game consoles, and personal digital assistants.

Microsoft has already announced its intent to expand its dominance beyond PC operating systems, servers, and applications to new devices and even personal information via its "eHome" and "Passport" initiatives. According to comments made by Microsoft President Steve Ballmer just last week, Microsoft is pursuing a "broader concept" for its client devices like the xBox and set-top box software. In his words, "[T]here's a bigger play we hope to get over time" by annexing all of these devices into the Microsoft empire. Microsoft's own demos and white papers show that it plans to establish its operating system as the software that would collect information streaming into the home and distribute it to each new device.

Microsoft has used and will continue to use its monopoly over desktop operating systems to deny competition in each new computing market as it evolves: first desktop applications, then internet browsers and servers, and now alternative devices ranging from smart phones to television set-top boxes.

By dealing only with a narrow category of Windows products, and failing even there to impose any significant restrictions, the Proposed Final Judgment fails to check Microsoft's demonstrated willingness to exploit its power over the operating system in order to dominate other market segments.

## **Background**

By way of personal background, I am the CEO of Liberate Technologies, a company making middleware software that enables interactive and enhanced television. Before joining Liberate, I was chairman and CEO of Sybase, then one of the world's ten largest independent software companies, founder and CEO of Powersoft, an enterprise software company, and chairman of both the American Electronics Association and the Massachusetts Software Council. I am also currently a director of CNET, Handspring, and TechNet.

Throughout my career, I have both partnered with and competed against Microsoft. I have been impressed by the power of its dominant platforms, but also concerned about the abuses that resulted from that dominance. I have seen Microsoft consistently use its power to block competition in new markets through at least three types of misconduct that the PFJ does nothing to deter: (1) Preventing original equipment manufacturers from supporting new technologies; (2) Tying commercial restrictions to investments; and (3) Blocking non-Windows-based industry standards.

### ***(1) Preventing Original Equipment Manufacturers from Supporting New Technologies***

My current company, Liberate, was originally Network Computer Incorporated, promoting computers and software that would operate via a network to significantly reduce the cost of computing. This model, like the Netscape browser, threatened the dominance of the Windows platform. But because the manufacturers of many new devices also manufacture desktop PCs, Microsoft was able to exploit its desktop OEM relationships to discourage competition. For example, Network Computer had an active relationship with Digital Equipment Corporation to develop a device running our software. Microsoft and Mr. Gates simply threatened the CEO of DEC that they would port Microsoft's NT operating system to DEC hardware only if DEC stopped development of a network computer, an offer DEC couldn't refuse. It's clear, and the courts have reaffirmed, that a monopoly simply cannot engage in this kind of conduct.

Such tactics forced us to exit this business, and the price of PC operating systems and applications remains as high as ever when all other computing costs have plummeted.

The Proposed Final Judgment focuses only on Windows products for desktop PCs and includes broad and ambiguous exceptions to its limits on retaliation. These loopholes would apparently let Microsoft get away with the kind of misconduct it perpetrated against Network Computer. The result would be to block or delay the development of new competitive devices and technologies. The remedy proposed by the non-settling states would, on the other hand, prevent Microsoft from engaging in this type of retaliation and unfairly extending its desktop monopoly to a wider array of software and devices.

### ***(2) Tying Commercial Restrictions to Investments***

Second, in investing the considerable proceeds of its desktop monopoly in new markets, Microsoft has extracted, or attempted to extract, exclusive or near-

exclusive commercial distribution arrangements to block out competitors. In the interactive television industry alone, Microsoft has invested billions of dollars with leading cable and satellite networks. As recently as this week, Microsoft has again aggressively pursued this strategy with leading operators both here and in Europe. The strings attached to these investments often require networks to buy Microsoft's middleware, making it difficult or impossible for them to buy competitive products.

Microsoft's money is a heavy thumb on the scale, biasing choices of future technologies in its favor. As new-generation computers and small consumer devices often rely on networks for their interconnections, these investments in network companies set the stage for continued dominance of these new platforms as they evolve.

Again, the PFJ fails to even address the issue of such restrictive dealings outside the scope of desktop products. In contrast, the remedies filed last week by the non-settling states, while not barring new investments, would at least require that Microsoft give 60 days notice to permit a review of anti-competitive effects.

### ***(3) Refusing to Support Non-Windows-Based Industry Standards***

Microsoft has also abused its monopoly position by blocking industry-wide standards essential to the evolution of a new generation of network-based devices. In our industry, Microsoft has undermined Java as a standard for digital television, lobbying heavily to prevent U.S. and European standards bodies from standardizing on Java. As you know, Java lets developers "write once, run anywhere", permitting content to run across a wide variety of platforms rather than just on Microsoft's proprietary code.

As a second prong of this strategy to block, co-opt, or "embrace and extend" standards, Microsoft has refused to join with other technology companies in pooling its intellectual property, instead indicating that it will sue to block the implementation of standards wherever it can find a violation of one of its patents. Microsoft certainly has the right not to support a standard. However, they are exploiting their dominance in the PC market to distort standards elsewhere.

Third, by removing the Java Virtual Machine from its PC operating systems while the JVM is common elsewhere, Microsoft discourages developers from creating new "write-once, run-anywhere" content, undermines support for uniform standards, and drives developers to write to proprietary Microsoft platforms.

It is clear that Microsoft's foot-dragging and affirmative interference has slowed the deployment of digital television in the United States. Cable companies and

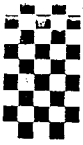
television manufacturers both say that a gating issue has been the lack of a definitive standard for digital television, a standard that Microsoft's tactics have delayed and undermined. Microsoft's approach stands in direct opposition to the clearly expressed will of Congress and the interests of all Americans interested in richer and more varied television programming.

Yet again, the PFJ would do nothing to prevent these abuses. The remedies recently filed by the non-settling states -- by making available Microsoft APIs and certain types of code, opening access to the personal identification data captured by Microsoft Passport, and requiring the distribution of the Java Virtual Machine - would promote technology interoperability and the development of universally beneficial standards while maintaining relatively open alternatives to Microsoft software and services.

### **Conclusion**

The PFJ is a disappointment. Disappointing because it is weaker than the facts and the law of the case support, and disappointing because it will not limit Microsoft's plans to dominate new markets in the same way it has dominated operating systems, applications, and servers in the past.

I welcome this hearing, and hope that this Committee will continue to exercise vigorous oversight of this case to assure that the final outcome is in the best interests of American consumers.



Ralph Nader  
P.O. Box 19312  
Washington, DC 20036

December 11, 2001

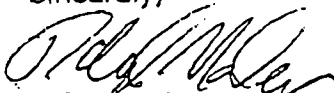
Senator Patrick Leahy  
Judiciary Committee  
US Senate  
Washington, DC

Via fax: 1.202.224.9516

Dear Senator Leahy:

This is a quick note to express my disappointment that I will not be among the panel members for the December 12, 2001 hearing on Microsoft. James Love on our staff made a number of telephone calls to your Judiciary Committee staff asking that he or I be permitted to testify, beginning as soon as the hearings were first announced. As you may know, we played an instrumental role in 1997 in pushing the Department of Justice to bring this antitrust case, and hosted two key conferences that helped frame the discussions over the case and the proposed remedies (<http://www.appraising-microsoft.org>). I am attaching also two letters James Love and I have recently sent regarding the government and private antitrust cases. Would you please include these letters in the printed hearing record. Thank you.

Sincerely,



Ralph Nader

Ralph Nader  
P.O. Box 19312  
Washington, DC 20036

James Love  
Consumer Project on Technology  
P.O. Box 19367  
Washington, DC 20036

November 5, 2001

Judge Colleen Kollar-Kotelly  
United States District Court for the District of Columbia  
333 Constitution Avenue, NW  
Washington, DC 20001

RE: US v. Microsoft proposed final order

Dear Judge Kollar-Kotelly,

#### Introduction

Having examined the proposed consent final judgment for USA versus Microsoft, we offer the following initial comments. We note at the outset that the decision to push for a rapid negotiation appears to have placed the Department of Justice at a disadvantage, given Microsoft's apparently willingness to let this matter drag on for years, through different USDOJ antitrust chiefs, Presidents and judges. The proposal is obviously limited in terms of effectiveness by the desire to obtain a final order that is agreeable to Microsoft.

We are disappointed of course that the court has moved away from a **structural** remedy, which we believe would require less dependence upon future enforcement efforts and good faith by Microsoft, and which would jump start a more competitive market for applications. Within the limits of a **conduct-only** remedy, we make the following observations.

On the positive side, we find the proposed final order addresses important areas where Microsoft has abused its monopoly power, particularly in terms of its OEM licensing practices and on the issue of using interoperability as a weapon against consumers of non-Microsoft products. There are, however, important areas where the interoperability remedies should be stronger. For example, there is a need to have broader disclosure of **file formats** for popular office productivity and multimedia applications. Moreover, where Microsoft appears to be given broad discretion to deploy intellectual property claims to avoid opening up its monopoly operating system where it will be needed the most, in

terms of new interfaces and technologies. Moreover, the agreement appears to give Microsoft too many opportunities to undermine the free software movement.

We also find the agreement wanting in several other areas. It is astonishing that the agreement fails to provide any penalty for Microsoft's past misdeeds, creating both the sense that Microsoft is escaping punishment because of its extraordinary political and economic power, and undermining the value of antitrust penalties as a deterrent. Second, the agreement does not adequately address the concerns about Microsoft's failure to abide by the spirit or the letter of previous agreements, offering a weak oversight regime that suffers in several specific areas. Indeed, the proposed alternative dispute resolution for compliance with the agreement embraces many of the worst features of such systems, operating in secrecy, lacking independence, and open to undue influence from Microsoft.

### **OEM Licensing Remedies**

We were pleased that the proposed final order provides for non-discriminatory licensing of Windows to OEMs, and that these remedies include multiple boot PCs, substitution of non-Microsoft middleware, changes in the management of visible icons and other issues. These remedies would have been more effective if they would have been extended to Microsoft Office, the other key component of Microsoft's monopoly power in the PC client software market, and if they permitted the removal of Microsoft products. But nonetheless, they are pro-competitive, and do represent real benefits to consumers.

### **Interoperability Remedies**

Microsoft regularly punishes consumers who buy non-Microsoft products, or who fail to upgrade and repurchase newer versions of Microsoft products, by designing Microsoft Windows or Office products to be incompatible or non-interoperable with competitor software, or even older versions of its own software. It is therefore good that the proposed final order would require Microsoft to address a wide range of interoperability remedies, including for example the disclosures of APIs for Windows and Microsoft middleware products, non-discriminatory access to communications protocols used for services, and non-discriminatory licensing of certain intellectual property rights for Microsoft middleware products. There are, however, many areas where these remedies may be limited by Microsoft, and as is indicated by the record in this case, Microsoft can and does take advantage of any loopholes in contracts to create barriers to competition and enhance and extend its monopoly power.

### **Special Concerns for Free Software Movement**

The provisions in J.1 and J.2. appear to give Microsoft too much flexibility in withholding information on security grounds, and to provide Microsoft with the power to set unrealistic burdens on a rival's legitimate rights to obtain interoperability data. More generally, the provisions in D. regarding the sharing of technical information permit

Microsoft to choose secrecy and limited disclosures over more openness. In particular, these clauses and others in the agreement do not reflect an appreciation for the importance of new software development models, including those "open source" or "free" software development models which are now widely recognized as providing an important safeguard against Microsoft monopoly power, and upon which the Internet depends.

The overall acceptance of Microsoft's limits on the sharing of technical information to the broader public is an important and in our view core flaw in the proposed agreement. The agreement should require that this information be as freely available as possible, with a high burden on Microsoft to justify secrecy. Indeed, there is ample evidence that Microsoft is focused on strategies to cripple the free software movement, which it publicly considers an important competitive threat. This is particularly true for software developed under the GNU Public License (GPL), which is used in GNU/Linux, the most important rival to Microsoft in the server market. Consider, for example, comments earlier this year by Microsoft executive Jim Allchin:

<http://news.cnet.com/news/0-1003-200-4833927.html>

"Microsoft exec calls open source a threat to innovation," Bloomberg News, February 15, 2001, 11:00 a.m. PT

One of Microsoft's high-level executives says that freely distributed software code such as Linux could stifle innovation and that legislators need to understand the threat.

The result will be the demise of both intellectual property rights and the incentive to spend on research and development, Microsoft Windows operating-system chief Jim Allchin said this week.

Microsoft has told U.S. lawmakers of its concern while discussing protection of intellectual property rights . . .

"Open source is an intellectual-property destroyer," Allchin said. "I can't imagine something that could be worse than this for the software business and the intellectual-property business." . . .

In a June 1, 2001 interview with the Chicago Sun Times, Microsoft CEO Steve Ballmer again complained about the GNU/Linux business model, saying "Linux is a cancer that attaches itself in an intellectual property sense to everything it touches. That's the way that the license works,"<sup>1</sup> leading to a round of new stories, including for example this account in CNET.Com:

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<sup>1</sup> <http://www.suntimes.com/output/tech/cst-fin-micro01.html> "Microsoft CEO takes launch break with the Sun-Times," Chicago Sun Times, June 1, 2001.



<http://news.cnet.com/news/0-1003-200-6291224.html>

"Why Microsoft is wary of open source: Joe Wilcox and Stephen Shankland in CNET.com, June 18, 2001.

There's more to Microsoft's recent attacks on the open-source movement than mere rhetoric: Linux's popularity could hinder the software giant in its quest to gain control of a server market that's crucial to its long-term goals

Recent public statements by Microsoft executives have cast Linux and the open-source philosophy that underlies it as, at the minimum, bad for competition, and, at worst, a "cancer" to everything it touches. Behind the war of words, analysts say, is evidence that Microsoft is increasingly concerned about Linux and its growing popularity. The Unix-like operating system "has clearly emerged as the spoiler that will prevent Microsoft from achieving a dominant position" in the worldwide server operating-system market, IDC analyst Al Gillen concludes in a forthcoming report.

... While Linux hasn't displaced Windows, it has made serious inroads. . .  
]. . In attacking Linux and open source, Microsoft finds itself competing "not against another company, but against a grassroots movement," said Paul Dain, director of application development at Emeryville, Calif.-based Wirestone, a technology services company.

... Microsoft has also criticized the General Public License (GPL) that governs the heart of Linux. Under this license, changes to the Linux core, or kernel, must also be governed by the GPL. The license means that if a company changes the kernel, it must publish the changes and can't keep them proprietary if it plans to distribute the code externally. . .

Microsoft's open-source attacks come at a time when the company has been putting the pricing squeeze on customers. In early May, Microsoft revamped software licensing, raising upgrades between 33 percent and 107 percent, according to Gartner. A large percentage of Microsoft business customers could in fact be compelled to upgrade to Office XP before Oct. 1 or pay a heftier purchase price later on.

The action "will encourage--'force' may be a more accurate term--customers to upgrade much sooner than they had otherwise planned," Gillen noted in the IDC report. "Once the honeymoon period runs out in October 2001, the only way to 'upgrade' from a product that is not considered to be current technology is to buy a brand-new full license."

This could make open-source Linux's GPL more attractive to some customers feeling trapped by the price hike, Gillen said. "Offering this form of 'upgrade protection' may motivate some users to seriously consider alternatives to Microsoft technology." . . .

What is surprising is that the US Department of Justice allowed Microsoft to place so many provisions in the agreement that can be used to undermine the free software movement. Note for example that under J.1 and J.2 of the proposed final order, Microsoft can withhold technical information from third parties on the grounds that Microsoft does not certify the "authenticity and viability of its business," while at the same time it is describing the licensing system for Linux as a "cancer" that threatens the demise of both the intellectual property rights system and the future of research and development.

The agreement provides Microsoft with a rich set of strategies to undermine the development of free software, which depends upon the free sharing of technical information with the general public, taking advantage of the collective intelligence of users of software, who share ideas on improvements in the code. If Microsoft can tightly control access to technical information under a court approved plan, or charge fees, and use its monopoly power over the client space to migrate users to proprietary interfaces, it will harm the development of key alternatives, and lead to a less contestable and less competitive platform, with more consumer lock-in, and more consumer harm, as Microsoft continues to hike up its prices for its monopoly products.

#### **Problems with the term and the enforcement mechanism**

Another core concern with the proposed final order concerns the term of the agreement and the enforcement mechanisms. We believe a five-to-seven year term is artificially brief, considering that this case has already been litigated in one form or another since 1994, and the fact that Microsoft's dominance in the client OS market is stronger today than it has ever been, and it has yet to face a significant competitive threat in the client OS market. An artificial end will give Microsoft yet another incentive to delay, meeting each new problem with an endless round of evasions and creative methods of circumventing the pro-competitive aspects of the agreement. Only if Microsoft believes it will have to come to terms with its obligations will it modify its strategy of anticompetitive abuses.

Even within the brief period of the term of the agreement, Microsoft has too much room to co-opt the enforcement effort. Microsoft, despite having been found to be a law breaker by the courts, is given the right to select one member of the three members of the Technical Committee, who in turn gets a voice in selecting the third member. The committee is gagged, and sworn to secrecy, denying the public any information on Microsoft's compliance with the agreement, and will be paid by Microsoft, working inside Microsoft's headquarters. The public won't know if this committee spends its time playing golf with Microsoft executives, or investigating Microsoft's anticompetitive

activities. Its ability to interview Microsoft employees will be extremely limited by the provisions that give Microsoft the opportunity to insist on having its lawyers present. One would be hard pressed to imagine an enforcement mechanism that would do less to make Microsoft accountable, which is probably why Microsoft has accepted its terms of reference.

In its 1984 agreement with the European Commission, IBM was required to affirmatively resolve compatibility issues raised by its competitors, and the EC staff had annual meetings with IBM to review its progress in resolve disputes. The EC reserved the right to revisit its enforcement action on IBM if it was not satisfied with IBM's conduct.

The court could require that the Department of Justice itself or some truly independent parties appoint the members of the TC, and give the TC real investigative powers, take them off Microsoft's payroll, and give them staff and the authority to inform the public of progress in resolving compliance problems, including for example an annual report that could include information on past complaints, as well as suggestions for modifications of the order that may be warranted by Microsoft's conduct. The TC could be given real enforcement powers, such as the power to levy fines on Microsoft. The level of fines that would serve as a deterrent for cash rich Microsoft would be difficult to fathom, but one might make these fines deter more by directing the money to be paid into trust funds that would fund the development of free software, an endeavor that Microsoft has indicated it strongly opposes as a threat to its own monopoly. This would give Microsoft a much greater incentive to abide by the agreement.

### **Failure to address Ill Gotten Gains**

Completely missing from the proposed final order is anything that would make Microsoft pay for its past misdeeds, and this is an omission that must be remedied. Microsoft is hardly a first time offender, and has never shown remorse for its conduct, choosing instead to repeatedly attack the motives and character of officers of the government and members of the judiciary.

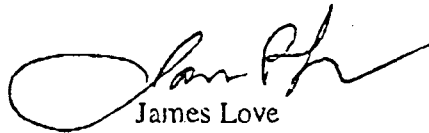
Microsoft has profited richly from the maintenance of its monopoly. On September 30, 2001, Microsoft reported cash and short-term investments of \$36.2 billion, up from \$31.6 billion the previous quarter -- an accumulation of more than \$1.5 billion **per month**.

It is astounding that Microsoft would face only a "sin no more" edict from a court, after its long and tortured history of evasion of antitrust enforcement and its extraordinary embrace of anticompetitive practices -- practices recognized as illegal by all members of the DC Circuit court. The court has a wide range of options that would address the most egregious of Microsoft's past misdeeds. For example, even if the court decided to forgo the break-up of the Windows and Office parts of the company, it could require more targeted divestitures, such as divestitures of its browser technology and media player technologies, denying Microsoft the fruits of its illegal conduct, and it could require affirmative support for rival middleware products that it illegally acted to sabotage. Instead the proposed order permits Microsoft to consolidate the benefits from past

misdeeds, while preparing for a weak oversight body tasked with monitoring future misdeeds only. What kind of a signal does this send to the public and to other large corporate law breakers? That economic crimes pay!

Please consider these and other criticisms of the settlement proposal, and avoid if possible yet another weak ending to a Microsoft antitrust case. Better to send this unchastened monopoly juggernaut a sterner message.

Sincerely,

  
Ralph Nader  
James Love

Cc: Stanley Sporkin, Judge Thomas Penfield Jackson, Anne K. Bingaman, Joel I. Klein

Ralph Nader  
P.O. Box 19312  
Washington, DC 20036

James Love  
**Consumer Project on Technology**  
P.O. Box 19367  
Washington, DC 20036

December 10, 2001

Judge Honorable J. Frederick Motz  
United States District Court  
District of Maryland  
101 West Lombard Street  
Room 510  
Baltimore, MD 21201

Fax: +1.410.962.2698

RE: Microsoft Corp. Antitrust Litigation, MDL No. 1332

Dear Judge Motz:

We are writing to ask that you reject the proposed settlement to the private antitrust actions against Microsoft, on the grounds that the settlement is inadequate in terms of the relief, anticompetitive in terms of its structure, and is among the least effective mechanisms for expanding access to educational services.

Microsoft has extraordinary global monopoly power in several essential software markets, including most notably its more than 90 percent market share for the operating systems (Windows), word processing (Word), spreadsheets (Excel) and presentation graphics (Powerpoint), and it has engaged in the equivalent of an antitrust crime spree, using an astonishing array of anticompetitive practices to consolidate and expand its monopoly power. As a consequence, consumers are denied the benefits of competition, and suffer from sluggish innovation, poor quality products, fewer choices, and high prices.

The Microsoft monopoly is highly profitable, and allowed Microsoft to accumulate an astonishing \$1.5 billion per month in cash last quarter. The proposed settlement of the private antitrust claim is not only a tiny sum in comparison to

Microsoft's sales (\$1 billion every 13 days currently), but it will not even be paid in cash. It isn't as if Microsoft can't afford to pay. It has cash reserves more than \$36 billion right now. Microsoft simply sees the resolution of this antitrust case as a great opportunity to engage in more anticompetitive conduct -- in this case converting its liabilities for antitrust damages into a slush fund to undermine its competitors in the educational market.

The court should not allow the lawyers who have proposed this settlement to bury this important antitrust case with yet another disappointment in the long history of weak efforts to reign in Microsoft's assaults on consumers. The settlement should not be yet another marketing effort by Microsoft aimed at the strategically important education market. It should provide a measure of justice that has yet eluded a long list of law enforcement officials.

We object to many aspects of the settlement.

- \* The size of the damages is small by any reasonable interpretation of the harm to consumers.
- \* Microsoft is demonstrating zero remorse for its price gouging, and indeed has engaged in its most aggressive price hikes to date, as it continues to narrow consumer rights in license agreements, raises standard and negotiated license fees (including those for the educational market), and steps up its coercive strategies to force upgrades, such as its abandonment of support for older licenses, and the introduction of new non-interoperable technologies that will not work without increasingly frequent upgrades.
- \* The proposal will make it even less attractive for schools to purchase products from Microsoft competitors, because Microsoft will subsidize its sales from the antitrust settlement costs, having the intended and entirely predictable effect of strengthening Microsoft's marketshare and weakening further its few remaining rivals. Moreover, to the degree that the funds from the settlement are small relative to the number of schools that will seek grants or donations, and if Microsoft is perceived to play any role in determining who obtains grants, schools may be reluctant to purchase products from Microsoft rivals, thinking this will undermine their chances of receiving benefits from the settlement fund, allowing Microsoft to leverage the anticompetitive effect of the settlement fund. (One need only look at the comments filed in this proceeding to appreciate how eager various non-profit institutions are to curry favor with Microsoft. Many groups that have received Microsoft grants are now on record opposing efforts to reject this settlement as inadequate and anticompetitive.) For schools, the more important issue is dealing with skyrocketing license fees, which this settlement will only address in a minor way, for a small number of users, and for only a short time.

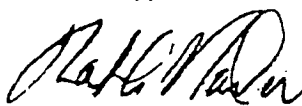
Comments of  
Ralph Nader and James Love

Page 3

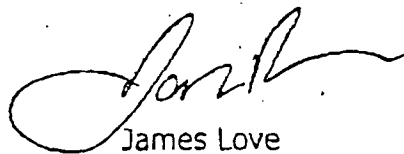
12/10/2001

If the court wishes to direct the settlement resources for the educational market, it should do so in such a way as to promote competition, rather than to reduce competition. One solution would be to place the money into a trust fund to be used only for purchases of non-Microsoft products, creating a needed boost to the market for alternatives. Another would be to require the funds be donated to groups who develop free software alternatives -- these very alternatives that Microsoft executives have claimed were their main competitive threat during the USDOJ/State AG antitrust litigation. Either of these approaches will directly address the longer term concern over software pricing, the problem this case seeks to remedy.

Sincerely,



Ralph Nader



James Love  
Consumer Project on Technology

**Written Statement of Mark Havlicek  
Digital Data Resources, Inc.  
Provided to the Senate Committee on the Judiciary  
Washington, D.C.  
December 12, 2001**

Thank you, Chairman Leahy and distinguished Members of the Committee including my own Senator Grassley. I am pleased to contribute my comments to your hearing on "The Microsoft Settlement: A Look to the Future." My name is Mark Havlicek and I am the President of Digital Data Resources, Inc. in Des Moines, Iowa. I have been actively involved in the technology industry for several years, and it is my hope that the Microsoft case will be settled.

The economic outlook for 2002 is very concerning. From coast to coast, revenue growth has slowed, spending is exceeding budgeted levels, and many states are looking at large budget cuts. My own state of Iowa is in the middle of a terrible budget crisis.

After the events of September 11, we saw a dramatic plunge in the technology sector. Instead of being tied up in court, technology entrepreneurs should at work developing products and charting new territory with never before imagined products and services. Given the opportunity and free of unnecessary hurdles to progress, technology companies can build our economy back up to record levels.

Giants like Apple, IBM, and Microsoft provide a stable environment for the myriad small firms, like mine, to create, develop, and release new cutting-edge technologies and employ additional people in good paying careers. Small companies like my own, work in concert, and competition at times, with these giants. This mutually dependent relationship is the lifeblood of our industry and a driving force behind our growth.

Over the past 20 years, we have seen computers go from the size of a refrigerator to the size of a deck of cards. And in tandem with those leaps forward, we have seen declining prices, better and faster technology, and increasingly more efficient methods of delivery to consumers.

It takes a competitive, entrepreneurial spirit to survive in this exceptionally aggressive industry of ours, especially in the case of small or emerging businesses. We spend our days watching competitors, finding markets, and keeping a watchful eye on the economy. And it seemed the storm has passed, both figuratively and in the eyes of the stock market, when a settlement was announced last month.

But the states, including my own state of Iowa, which remain involved have argued for tougher enforcement provisions, including a court-appointed "special master" to oversee Microsoft's compliance. And we have found through experience that there is no remedy discrete to Microsoft when it's the nucleus of a tech sector that operates as its own economy.



These states are not right to push ahead for further prosecution of Microsoft. The proposed settlement is sufficient to address the concerns of business people like me who are in the technology industry and are most affected. Companies like mine strive to be similar to Microsoft and we are discouraged by the hold-out states position on further action. It seems to me to be a strong disincentive to progress and entrepreneurial achievement.

The time to take a hard line on successful companies like Microsoft is over. The hold-out states are holding out to the detriment of their state economies and our national economy at a time when actions like this are not at all useful.

It is a frightening prospect to see another dollar of precious development resources diverted to paying attorneys' fees instead of rippling through our industry. Money that could have launched a new product or created new opportunities for a small business on the brink instead has disappeared into the abyss of this lawsuit. The settlement is a positive step in putting it all behind us and opening a new chapter in the life of the technology industry.

I applaud Assistant Attorney General Charles James for his role in bringing the case this far. The settlement agreement is a strong one. It will have an enormous, positive impact on the future of my company and the entire software industry. My colleagues and I hope we can rely on your support. Thank you, Senators, for the opportunity to provide this statement at such a critical for our nation.

Thank You,

MARK HAVLICEK  
PRESIDENT  
DIGITAL DATA RESOURCES, INC.  
920 MORGAN STREET, SUITE N  
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515-243-3622 PHONE  
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Testimony by  
[Jerry Hilburn, President and Founder]  
Catfish Software, Inc.

Provided to the  
U.S. Senate Committee on the Judiciary  
December 12, 2001

I am very pleased to provide a written statement for your hearing on "The Microsoft Settlement: A Look to the Future." Thank you, Chairman Leahy and Members of the Committee, for the opportunity to deliver a small businessperson's perspective on the case before this distinguished group.

I would like to tell you my point of view on the Microsoft case. I am a small businessman in San Diego, California. Catfish Software, Inc. started operations in 1994 providing network services and custom database applications for small business. In 1998, Catfish Software launched an E-mail Application Services branch providing double opt-in mail list service and web-based customer support applications and today, Catfish Software provides support to 300+ companies reaching 2,000,000+ subscribers of its software services.

One of my firm's top competitors is Microsoft's bCentral. So you may ask why I speak in favor of the Microsoft settlement.

Businesses large and small have mortgaged their futures against the impact of the terrorist war. Some smaller businesses – technology and otherwise – have already found themselves strangled by a lack of consumer demand and by slowdowns in corporate and consumer spending. Most of us are finding it is time to shore up resources and protect our assets from the impact of the war.

In this time of so much uncertainty, we need the promise of a brighter day and the knowledge that the government – from the federal level on down – is doing everything possible to invigorate our flagging economy.

Competition and consumer preference should decide the direction of the marketplace and meanwhile, the government should not rush to intervene in the New Economy. The last thing our economy needs at this time is the burden of remedies which do nothing but slow the pace of development and limit the choices of consumers.

The Justice Department handled this case admirably, and the settlement they agreed upon is sound. The settlement outlines how Microsoft can operate, but more importantly it provides some assurances to an industry that has been on unstable ground lately.

Microsoft's ability to design and produce new software in turn creates opportunities for small and medium-sized developers to write applications which operate on a Windows-based platform.

As the old saying goes, a high tide floats all ships. Calls for break-up of the company did not help the already tenuous situation. And when Microsoft looked like it might be pulled under, the Nasdaq was hit as well as the stocks of many high-tech companies.

But when announcements of the settlement were made public around the beginning of November 2001, everyone got a nice little bump. Consumers and other technology entrepreneurs were hopeful that this case could be put to bed and that the tech sector could get back to business.

This litigation that has been an albatross around all our necks for so long -- and ending the string of lawsuits associated with it -- will have a positive effect on the tech economy. With a little luck, that will ripple out to America's economy as a whole.

With so many technologies poised to enter the marketplace, Microsoft and many others, including Catfish Software are looking for ways to enhance the computing experience. The Internet has become a center of most everyone's daily lives -- from toddlers typing their first strokes with learning games to seniors learning how to send and receive e-mail. Untapped markets and unimagined ideas abound, but we must not harness the creativity or the ability of software firms to bring those products to bear in the marketplace.

The olive branch of settlement was extended, and it is a solution that is good for the economy and good for the tech industry. Allow us the opportunity to get back to work and earn money with our products and ideas once again.

This concludes my testimony. Once again, I thank the Committee and its distinguished Members for the opportunity to provide written testimony on this important issue.

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Arlington, VA 22203-1624  
Tel (703) 812-1333  
Fax (703) 812-1337  
publicpolicy@comptia.org

**\*\*\* CompTIA®**

## **THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE**

Written Testimony Submitted by the  
**Computing Technology Industry Association**  
in Connection with Senate Committee on the Judiciary Hearings

December 12, 2001

Prepared by  
Lars H. Liebeler, Esq.  
Thaler Liebeler LLP  
1919 Pennsylvania Avenue, N.W.  
Suite 200  
Washington, D.C. 20006  
CompTIA Antitrust Counsel  
(202) 828-9867

## THE MICROSOFT SETTLEMENT: A LOOK TO THE FUTURE

### STATEMENT OF INTEREST

The Computing Technology Industry Association (CompTIA) is the world's largest trade association in the information technology and communications sector. CompTIA represents over 8,000 hardware and software manufacturers, distributors, retailers, Internet, telecommunications, IT training and other service companies in over 50 countries. The overwhelming majority of CompTIA members are resellers – companies that resell software and hardware to consumers, businesses, or other resellers. These resellers are vendor-neutral and their objective is to be able to sell whatever products their customers wish to buy. In that sense they believe that antitrust laws should focus primarily on consumer impact rather than competitor impact. Microsoft is a member of CompTIA as are many of Microsoft's competitors.

In 1998, CompTIA's Board of Directors adopted a formal policy statement on antitrust. That statement supports sensible antitrust enforcement that is based on demonstrable economic effects in the marketplace. CompTIA believes that market forces typically correct any temporary market imperfections and that government regulators should only intervene in the technology marketplace when there is overwhelming evidence of a substantial and pervasive market failure. Pursuant to its policy statement, CompTIA has written and spoken frequently on antitrust issues of relevance to the technology sector. In June 1998, CompTIA filed an *amicus* brief in the *Intel v. Intergraph* litigation in the U.S. Court of Appeals for the Federal Circuit. In that case CompTIA urged the court to reject a lower court's finding that antitrust allegations could be a basis for ordering a company to disclose its valuable intellectual property.

CompTIA filed an *amicus* brief in the United States Court of Appeals for the District of Columbia Circuit in the *United States v. Microsoft* case in November 2000. The *amicus* brief

urged the Court of Appeals to reverse the District Court's order breaking Microsoft into two separate companies and further urged the Court of Appeals to reverse the liability findings against Microsoft. The basis for CompTIA's participation as *amicus* and submission of this testimony to the Committee is its interest in the overall health and prosperity of the technology sector.

The antitrust case against Microsoft and the final remedies that will be imposed upon Microsoft have a direct effect on the overall health and prosperity of the technology sector. First, because Microsoft is such a large and important participant in the technology industry, any remedy that affects the company's operations necessarily affects the industry, Microsoft's vendors, and all companies that rely on Microsoft products. A remedial order that goes beyond the issues in the case may have a significantly detrimental effect upon innovation and growth in the industry. Second, the precedent established in this case has important ramifications for future activities in the technology sector. Overly restrictive sanctions imposed upon Microsoft may act to inhibit competitive behavior by other companies throughout the industry thereby deterring conduct that promotes innovation and technological development.

## **INTRODUCTION**

On November 6, 2001 the United States Department of Justice and nine States entered into a Proposed Final Judgment with the Microsoft Corporation that resolves the antitrust charges brought by those governmental entities against the company. In the days after the settlement was announced, the nine non-settling States and the District of Columbia expressed their intention to continue litigation against Microsoft in an effort to convince the United States District Court that more extensive remedies should be ordered. On December 7, 2001 the non-settling States filed their remedy proposal with the District Court.

This testimony analyzes the Court of Appeals opinion, the November 6, 2001 Proposed Final Judgment, and the non-settling States' remedy proposal and arrives at the following conclusions:

- The U.S. Court of Appeals June 28, 2001 opinion reaffirmed that the central goal of the U.S. antitrust laws is *not* to protect competitors from competition nor is it to penalize a defendant. The central goal of the antitrust laws is to promote competition in order to enhance consumer welfare.
- In order to support its remedy in the remand proceeding now before the District Court, the Court of Appeals opinion requires that the government show a significant causal connection between Microsoft's anticompetitive conduct and actual injury to competition and consumers in the marketplace. If the government fails to prove a causal connection, then the remedy imposed can be no more broad than an order enjoining the specific anticompetitive conduct at issue.
- Given the risks to both sides from further litigation, the November 6 Proposed Final Judgment is a reasonable settlement of the remaining disputed issues in the case that insures that Microsoft's anticompetitive conduct will not be repeated, and insures that every market participant has a fair opportunity to compete. The settlement also insures that the technology industry will not be encumbered with excessive regulation that would stifle innovation and growth.
- The additional remedies proposed by the non-settling States on December 7 are not likely to enhance competition or promote consumer welfare. The vast majority of the States' proposals go far beyond the scope of the liability found by the Court of Appeals and are thus legally unsupportable. Further, the proposed remedies would likely interfere with natural market forces, impose higher costs on consumers, impair innovation, and benefit Microsoft's competitors at the expense of consumers.

## **I. SUMMARY OF THE COURT OF APPEALS OPINION**

### **A. Background**

On June 28, 2001 the United State Court of Appeals for the District of Columbia Circuit

("Court of Appeals") issued its ruling in *United States v. Microsoft*. The Court of Appeals found that Microsoft had violated Section 2 of the Sherman Act by taking anticompetitive actions to protect its monopoly in the computer operating system market. The Court, however, reversed the District Court rulings entered adverse to Microsoft regarding tying, attempted monopolization, and imposition of a break-up remedy. The case has been remanded to the District Court for proceedings on the appropriate remedy to address the monopoly maintenance findings.

While much of the Court of Appeal's opinion focuses on issues that are specific to Microsoft, the Court made two preliminary yet important observations with respect to antitrust enforcement activities in the high-tech sector. First, the Court noted that despite the relatively fast pace of the Microsoft proceedings, the speed at which technologically dynamic markets undergo change is even faster. The consequences of the speed at which the market changes has significant implications for the conduct of antitrust cases. This rapid change "threatens enormous practical difficulties for courts considering the appropriate measure of relief in equitable enforcement actions, both in crafting injunctive remedies in the first instance and reviewing those remedies in the second." Opinion at 10-11.

Because technology moves so quickly there is little likelihood that a company with large market share at any given time can engage in anticompetitive exclusionary behavior that causes consumer injury. In many instances a more desirable successor technology may very rapidly displace a large market share company before that company is even able to attempt to exercise monopoly power.

Second, the Court also noted that competition in the technology marketplace is frequently "competition for the market" rather than "competition in the market." This means that there is intense competition between firms when a new product is introduced, but once consumers choose the firm that makes the best product, that firm will likely garner the vast majority of market share. This "network effect" phenomenon means that as more users utilize a compatible and inter-operable system or service, the value to each user increases. Opinion at 11-12. Thus, the



Court of Appeals made clear that lawful monopolies and companies with large market shares are frequently desirable and highly beneficial to consumers. Opinion at 11.

The Court of Appeal's inclusion of this theoretical discussion is a broad response to the question that many have asked since the beginning of the Microsoft case – that is, do the antitrust laws, written and applied predominantly in a brick-and-mortar era, have the same level of relevance in the information technology era? The answer is mixed. The antitrust laws do apply to the new economy, but the application of the rules must take into account economic realities and to insure that the objectives of antitrust are achieved: the protection and enhancement of competition as measured by consumer welfare.

The most dramatic illustration of the application of antitrust to the new economy was in the Court's rulings on the tying claim and in reversing the lower court's remedial order. The Court's application of a rule of reason analysis (rather than *per se* treatment) for tying claims while at the same time rejecting the "separate products" test marks a significant recognition that product integration in the technology sector is likely to have benefits to consumers that outweigh any harms to competition. Additionally, the Court's analysis in rejecting the lower court's break-up order suggests that absent a strong showing of a causal connection between anticompetitive acts and Microsoft's dominant position in the operating system market, radical structural relief or extensive conduct restrictions that go beyond the challenged conduct would be unsupportable.

## **B. Monopoly Maintenance**

The Court of Appeals affirmed in large measure the District Court's ruling that Microsoft acted unlawfully to maintain its monopoly in the operating system market. The Court found that Microsoft viewed Netscape Navigator Internet browser as a potential threat to the Windows operating system because it could conceivably have become an intermediate platform (with exposed application programming interfaces or API's) for the development of software applications. In order to promote Internet Explorer and retard the distribution of Netscape

Navigator, Microsoft placed restrictions on original equipment manufacturers (OEM's). OEM's were not permitted to remove the Internet Explorer icon or install a Navigator icon on the desktop.

The Court also found that the way in which Internet Explorer was integrated into Windows was unlawful. Beginning with the release of Windows 98, Microsoft removed Internet Explorer from the list of programs that could be accessed using in the add/delete program feature. The Court found that this had the effect of impeding the inclusion of rival browsers on a computer because OEM's were reluctant to place two Internet browsers on the desktop. Because Microsoft did not offer any pro-competitive justification for preventing the removal of Internet Explorer, the Court found this feature unlawful. The Court also found that Microsoft's dealings with some independent software vendors, Apple Computer Corp., Java, and Intel were designed solely to protect its operating system monopoly and therefore those dealings violated Section 2 of the Sherman Act.

Shortly after the Court of Appeals decision was released, Microsoft announced that it would modify its release of Windows XP to respond to the Court of Appeals rulings in the monopoly maintenance section of the opinion. Thus, OEM's now are permitted to have more control over the appearance of the Windows desktop; they may add icons for competing software and on-line services and delete the Internet Explorer icon from the desktop. OEM's and consumers also have the ability to remove Internet Explorer icon from a computer using the

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<sup>1</sup> Shortly after the Court of Appeals issued its ruling, Microsoft asked the court to reconsider the finding that Microsoft had unlawfully "commingled" code from Internet Explorer and Windows. Microsoft argued that as a factual matter the District Court was incorrect in finding that Microsoft actually had placed Windows code and Internet Explorer code in the same libraries in order to prevent IE from being removed. The Court of Appeals denied Microsoft's petition for rehearing on this issue but wrote that Microsoft could raise this issue on remand with respect to the appropriate remedy in the case. Microsoft's actions in allowing OEM's and/or consumers to remove the Internet Explorer icon and program link (and the inclusion of that concession in the settlement agreement) appears to address the Court's concerns regarding exclusion of rival browsers. Thus, any interpretation of the Court of Appeals decision to require that Microsoft re-engineer Windows to duplicate shared code functions and then remove the IE code (as the non-settling States interpretation does) would be inconsistent with the language and policy of the opinion as a whole. Further, the Court of Appeals found that shared library files that perform functions for both the operating system and the browser enhance efficiency. Opinion at 73.

add/delete function.<sup>1</sup>

### C. Attempted Monopolization

The Court of Appeals reversed and dismissed the District Court's finding that Microsoft unlawfully attempted to monopolize the Internet browser market. Opinion at 62-68. The District Court had found that Microsoft's 1995 proposal to divide the browser market with Netscape created a dangerous probability of monopoly and that Microsoft's aggressive marketing of Internet Explorer after June 1995 also created a dangerous probability of monopoly. But the Court of Appeals found that the government had failed to properly identify the relevant market including reasonable substitutes for Internet browsers. Further, the Court also found that there was no showing of significant barriers to entry in any putative browser market.

The Court's ruling on attempted monopolization has significant implications for future business activities in the technology sector. If the District Court rule had been upheld, the resulting rule would have made it virtually *per se* unlawful for successful firms to explore collaborative relationships with emerging competitors. Further, it would permit a "dangerous probability of success" to be proven simply by showing that a firm has secured a 50-60 percent market share without requiring any showing that the firm will ever be in a position to exercise market power – that is, the power to raise price and exclude competitors. Both propositions would have had serious adverse repercussions for the IT industry and would have likely blocked countless pro-competitive competitor collaborations that would benefit consumers.

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#### D. Tying

The District Court found that Microsoft's inclusion of Internet Explorer with Windows was a *per se* unlawful tying arrangement. The Court of Appeals reversed this conclusion and ruled that *per se* analysis was inappropriate for arrangements involving platform software products. Because the inclusion of added functionality into software products has the potential to be pro-competitive and generate vast consumer benefits, integration in this area must be judged under the rule of reason. The Court of Appeals remanded the tying claim to the District Court for analysis under the rule of reason. Opinion at 68-90. Under the rule of reason, however, future antitrust plaintiffs must bear a heavy burden to prove that software integration unlawful.

Historically tying arrangements have been deemed *per se* unlawful. But the Court properly recognized that software products are "novel categories of dealings" and that this case provided the "first up-close look at the technological integration of added functionality into software that serves as a platform for third-party applications. There being no close parallel in prior antitrust cases, simplistic application of *per se* tying rules carries a serious risk of harm." Opinion at 69. The Court also noted the benefits from software integration: "Bundling obviously saves distribution and consumer transaction costs." Opinion at 73.

In recognizing the potential benefits from integration, the Court then determined that the "separate products" test under *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) – that is, if the tying and tied products are "separate products" then the integration is unlawful – was not appropriate for platform software analysis.

Finally, the Court of Appeals issued precise instructions to the District Court in considering the tying in the event the government were to pursue the claim on remand. Those instructions preclude the plaintiffs from arguing any theory of anti-competitive harm based on a precise definition of the browser market or barriers to entry in the putative browser market. Opinion at 87. Faced with this new legal standard, the United States, on September 6, 2001, announced that it would not pursue the tying claim on remand.

In sum, adding new functions to existing software is a nearly universal form of innovation in the software industry and is essential in persuading customers to upgrade from their existing software to a new, improved version. For example, word processing programs have incorporated formerly separate spell-checkers and outliners, personal finance programs have incorporated tax functions, internet service providers have incorporated instant messaging features, database software companies are integrating their databases with their applications server, and e-mail programs have incorporated contact managers. If companies that gain a "dominant" position in a given field were barred from innovating in this manner, consumers would be denied new benefits that result from integration, and the software industry would stagnate. The Court of Appeals rejection of a *per se* rule for platform software integration, and the government's subsequent decision to drop that claim on remand, insures that technological innovation will be permitted to continue and provide consumers additional benefits.

#### **E. Remedy**

The Court of Appeals fundamentally altered the basis of liability found by the District Court and thus the structural and conduct remedies imposed by the lower court were reversed. Opinion at 106. The Court of Appeals correctly noted that an antitrust remedy must focus on restoring competition and the District Court must explain how its remedy will do so. Opinion at 99-100. Central to the inquiry of how to restore competition is the identification of specific injury to the competitive process by the defendant's behavior. Thus, the Court of Appeals directed the District Court on remand to make a finding of a "causal connection" when assessing an appropriate remedy. Opinion at 105.

While the Court of Appeals left the District Court with a large measure of discretion in fashioning an appropriate remedy on remand, there are repeated and clear directions that the evidence necessary to sustain a structural remedy or extensive conduct remedy must be very strong. Opinion at 105-06. Faced with this language, the United States announced on September 6, 2001 that it would no longer seek break up of Microsoft. The individual States have also

dropped their demand for a structural remedy.

The remaining issue for the new District Court judge on remand, Colleen Kollar-Kotelly, is to fashion an appropriate remedy for the monopoly maintenance findings that were affirmed by the Court of Appeals. Here too the Court of Appeals has provided some general guidance. The appropriate remedy for Microsoft's antitrust violations may be "an injunction against continuation of that conduct." Opinion at 105. The language cited by the non-settling States that the unlawful monopoly "must be terminated" would only apply in the context of a demand for structural relief. The non-settling States have not made a demand for structural relief, nor have they made a showing of a causal connection between Microsoft's unlawful behavior and actual harm in the marketplace.

## **II. SUMMARY OF THE PROPOSED FINAL JUDGMENT**

After the November 6, 2001 Proposed Final Judgment was announced many of Microsoft's competitors complained that the settlement was too lenient. The settlement, however, should not be designed as a wish list for Microsoft's competitors. The settlement should fairly address the areas of liability found by the Court of Appeals. Anything less would encourage Microsoft and other companies to engage in anticompetitive conduct in the future; anything more would inappropriately imperil the technology marketplace, cause harm to consumers, and likely be struck down by the Court of Appeals. Additionally, the settlement necessarily takes into account the fact that the issue of causation has not yet been decided by the Court. In light of the scope of the Court of Appeals decision and the uncertainty facing both sides from further litigation, the November 6 Proposed Final Judgment is a reasonable compromise of the antitrust litigation.

The November 6 Proposed Final Judgment addresses the liability issues in the monopoly maintenance section of the Court of Appeals decision, and correctly does not seek to impose a remedy related to other areas in which Microsoft prevailed on appeal -- attempted monopolization and tying.

First, the settlement prohibits Microsoft from retaliating against any OEM because of the OEM's participation in promoting or developing non-Microsoft middleware or a non-Microsoft operating system. This provision takes the "club" out of Microsoft's hand and prevents the company from using anticompetitive means to discourage OEM's from promoting or preventing rival software from being developed or installed on Windows desktop. This anti-retaliation provision deals head on with most of the conduct the Court of Appeals found to be illegal in the monopoly maintenance section of its June 28, 2001 opinion.

Second, Microsoft is obligated to adhere to one uniform license agreement for Windows with all OEM's and the royalty for the license shall be made publically available on a web site accessible by all OEM's. The price schedule may vary for volume discounts and for those OEM's who are eligible for market development allowances in connection with Windows products. This allows Microsoft to continue to compete in the middleware market with other middleware manufacturers and this competition will continue to benefit consumers.

Third, OEM's are permitted to alter the appearance of the Windows desktop to add icons, shortcuts and menu items for non-Microsoft middleware, and they may establish non-Microsoft programs as default programs in Windows. Consumers also have the option of removing the interface with any Microsoft middleware product.

Fourth, Microsoft must reveal the API's used by Microsoft middleware to interoperate with the Windows operating system. Microsoft must also offer to license its intellectual property rights to any entity who has need for the intellectual property to insure that their products will interoperate with the Windows operating system.

These central features of the settlement insure that other companies have the ability to challenge Microsoft products, both in the operating system and middleware / applications markets. Consumers and OEM's have far greater freedom to instal and use non-Microsoft products, Microsoft is prohibited from retaliating against any entity who promotes non-Microsoft programs, and all companies have equal access to Microsoft API's and technical information so

that non-Microsoft middleware has the same opportunity to perform as well as Microsoft middleware.

The enforcement mechanisms of the settlement will enable the plaintiffs to insure Microsoft's compliance with the agreement. Representatives of the United States and the States may inspect Microsoft's books, records, source code or any other item to insure compliance with the settlement terms. In addition, an independent three person technical committee will be established to insure that Microsoft complies with all terms of the settlement agreement. The technical committee will have full access to all Microsoft source code, books and records, and personnel and can report to the United States and/or the States any violation of the settlement by Microsoft.

### **III. SUMMARY OF THE NON-SETTLING STATES' DECEMBER 7 PROPOSAL**

While the November 6 Proposed Final Judgment goes beyond the liability found by the Court of Appeals in some areas (i.e., by requiring Microsoft to disclose its confidential technical information to software developers), the non-settling States' proposal filed on December 7, 2001 goes so far beyond the judgment as to bear little relationship to the Court of Appeals decision.

The centerpiece of the states' remedy demand is that Microsoft be compelled to create and market a stripped down version of its Windows operating system that would not include many of the features that current versions of Windows do include. Since consumers can now easily remove Microsoft features from their desktop and OEM's are free to place non-Microsoft programs on the desktop, it is difficult to see how this requirement would benefit consumers.

Instead of giving consumers more choices of software products, this unwarranted intrusion into marketing and design decision by the non-settling States would cause further delays in the development of software created to run on XP, with developers waiting to see which version would become the standard. Such delays would further postpone the salutary effects of XP on the computer market. It would also hamper programmers' ability to take full advantage of technological improvements in Windows, creating a marketplace in which the same



software applications would not perform equally. This remedy would balkanize the computing industry and would undermine the benefits consumers obtain from a standardized operating platform.

In addition to the stripped down version of Windows, the December 7 proposal would also require Microsoft to continue licensing and supporting prior versions of Windows for five years after the introduction of a new version of Windows. The primary effect of this requirement is to impose unnecessary costs upon Microsoft (that would likely be passed on to consumers) and reduce the incentives for Microsoft to improve the operating system. This disincentive to Microsoft to make technological advances would ripple throughout the software industry as applications developers would not have an advancing platform to write software to.

The non-settling States remedy proposal also includes a variety of restrictions that will have little if any quantifiable benefit to consumers but which will simply advance the interests of Microsoft competitors. Consumers and OEM's currently have full ability and freedom to include Java software on their computers; the States' requirement that Microsoft carry Java on all copies of Windows does not provide consumers or OEM's with any more choice than they already have. Similarly, the requirement that Microsoft continue to produce an Office Suite for Macintosh interferes with natural market forces that direct resources to the best use and may actually preclude the success of competing applications software. Directing Microsoft to produce and support any software without regard for market forces is likely to harm consumers, not help them. Moreover, the November 6 Proposed Judgment fully addresses and prevents Microsoft from retaliating or taking any anticompetitive actions against Apple.

Advances in technology are frequently made as a result of joint ventures between competitors. The Department of Justice and the Federal Trade Commission have recently released guidelines for the formation of such joint ventures. Notwithstanding the recognition by these enforcement agencies that most joint ventures are pro-competitive, the non-settling States seek to restrict Microsoft from entering into joint ventures whereby the parties to the joint

venture agree not to compete with the product that is the subject of the joint venture. This restriction will chill innovation and prohibit countless consumer welfare enhancing arrangements. Further, this proposal flatly ignores the fact that the Court of Appeals found in Microsoft's favor on the issue of the alleged illegality of its joint venture proposal to Netscape.

The most harmful of the remaining remedy proposals include those that require the extensive and mandatory sharing of Microsoft's intellectual property. The non-settling States proposals in this regard go well beyond those in the November 6 Proposed Final Judgment and appear to be aimed at benefitting Microsoft's competitors rather than insuring a level playing field for all participants in the software industry. In the absence of compelling justification for wholesale and forced disclosure of a company's intellectual property, the harm caused by such disclosure is unwarranted and harmful to the entire technology marketplace. The vigorous protection of intellectual property has fueled the rapid and dynamic growth of the technology industry. Actions that erode protections for intellectual property should be viewed with great trepidation.

The long term effects of the conduct restrictions proposed by the non-settling States encourage continued litigation, rather than competition in the marketplace.

## **CONCLUSION**

The Microsoft settlement and any remedies imposed must be judged in the context of the Court of Appeals opinion. The non-settling States remedial proposals go well beyond the liability found by the Court of Appeals. The Microsoft case, and this Committee hearing, should not be a forum for any government actor, no matter how well-intentioned, to try to reconfigure the marketplace based on guesswork and supposition. History has told us time and time again that government's efforts to micro-manage markets are far more likely to fail than to succeed. Consumers stand to lose the most.

The Plaintiffs have never challenged Microsoft's acquisition of its dominant position in the operating system market. Microsoft was propelled into this position as a result of consumer

choice. Consumers derive great benefit from the adoption of a standardized operating system platform. State antitrust officials and the courts should be wary of imposing remedies that would interfere with the positive network effects resulting from the large number of consumers who choose Windows.

Government intervention in the marketplace can only be justified if the intervention is a reasonably accurate proxy for the actions that would occur in a competitive market. Otherwise, the unintended consequences of well-meaning government intervention are very likely to do more harm than good. It is simply beyond the capability of the courts and regulators to predict the direction and development of almost any market, let alone the highly dynamic markets in the technology industry. This counsels against the extensive and rigid conduct restrictions proposed by the non-settling States.

Statement of Dave Baker  
Vice President for Law and Public Policy  
EarthLink, Inc.  
Senate Judiciary Committee  
Hearing on  
"The Microsoft Settlement: A Look to the Future"  
Wednesday, December 12, 2001

My name is Dave Baker and I am Vice President for Law and Public Policy with EarthLink. EarthLink is the nation's 3<sup>rd</sup> largest Internet Service Provider, bringing reliable high-speed internet connections to approximately 4.8 million subscribers every day. Headquartered in Atlanta, EarthLink provides a full range of innovative access, hosting and e-commerce solutions to thousands of communities over a nationwide network of dial-up points of presence, as well as high-speed access and wireless technologies.

EarthLink is concerned with the potential for Microsoft to use its affirmed monopoly position in operating systems to leverage its position in innovative Internet services provided by Internet Service Providers (ISPs) including Internet access and associated services.

The proposed Justice Department settlement with Microsoft allows them to continue to restrict competition and choice in ISP services by failing to classify e-mail client software and Internet access software as "middleware". By not including e-mail client and internet access software in the definition of middleware, this proposed settlement allows Microsoft to force OEMs to carry Microsoft's own ISP service, Microsoft Network (MSN), while restricting them from carrying competing e-mail client software or internet access software. The federal settlement also allows Microsoft to prohibit OEMs from removing the MSN from their products.

The alternate settlement proposed by nine States and the District of Columbia would define middleware to include e-mail client software and Internet access software, thereby preserving competition in these markets. This distinction in the definition of middleware makes a huge difference given the diverse nature of the ISP marketplace. Many ISPs will never find a place on the Microsoft desktop if Microsoft can prohibit OEMs from including competing e-mail client software and Internet access software, or if Microsoft is able to make such software incompatible with the Windows operating system.

ISPs provide distinct and valuable services beyond mere Internet connectivity. For example, ISPs provide specialized content, web hosting, e-commerce, content specialized for wireless access, and other innovative new products. ISPs provide free local computer and Internet classes for their customers, include local content on their home page, or provide free connections for community groups. EarthLink, while serving a broad range of users across the country, has made greater privacy protection a distinguishing feature of its ISP service. This diverse choice of service and source of future innovation is at risk if Microsoft is able to leverage its existing monopoly power in operating systems to all but force consumers to use its Internet access service, MSN, at the expense of other choices in internet service.

Over the past few years, Microsoft has bundled its internet service more and more closely with succeeding versions of the Windows operating system. This has allowed Microsoft to constrict consumer choice in Internet access providers. In Windows 98, consumers had a choice of several ISPs from which to select for Internet access. Each ISP was listed in the same manner, with equal sized boxes on a referral server screen. In Windows Me, the MSN butterfly icon was the only ISP icon featured right on the desktop, giving it an advantage shared by no other ISP. Consumer had to click down through several screens to find other ISPs. Now, Windows XP has a dialogue boxes that pops up and several times to try to sway consumers to sign up for MSN internet service. While it is possible to select another ISP, this choice is buried and requires greater effort and diligence on the part of the consumer. This illustrates how Microsoft can use its control of the desktop to promote its own Internet access and related content, applications and services.

Under the proposed federal settlement, even this limited choice can be eliminated by Microsoft, since they would be free to restrict OEMs from offering other ISPs on the desktop or from removing Microsoft's own icons from the desktop.

On a related topic, Microsoft recently offered to settle numerous lawsuits by donating computer equipment to schools. Apple Computer has raised concerns that this donation would give Microsoft an inappropriate advantage in gaining greater market share for its operating system in the competitive school marketplace. EarthLink is also concerned that Microsoft would use the proposed computer donations (a good thing) to their own advantage by providing these schools with a product that bundles Internet access with equipment and operating software. This would again unfairly steer consumers, including as here those least able to exercise choice in their internet applications, into using just associated Microsoft products.

We note that the E-Rate, the federal grant program for school connectivity, requires that schools be allowed to purchase Internet access from a range of competitive providers. The government's clear intent is for schools to have a choice of competitive Internet access providers, in order to promote the broadest selection of services, diversity and choice of features, and lowest prices for Internet access. This intent would be undermined if Microsoft uses its proposed computer donations as a "Trojan horse" to install yet more of its own e-mail client and Internet access software. We encourage the

preservation of choice for these schools and their students in their selection of Internet access and related services.

EarthLink is concerned that just as Microsoft used its Windows operating system monopoly to force consumers to use the Microsoft browser, Internet Explorer, at the expense of competitors such as Netscape Navigator, Microsoft is now seeking to use the same leverage to force consumers to use their Internet service provider, MSN. EarthLink supports the alternate settlement proposed by the nine States to preserve competition in the market for email client software and Internet access software by including these services in the definition of middleware. As it considers the future of the Internet marketplace, we encourage the Committee not to allow Microsoft to leverage its existing monopoly into new and evolving Internet services. Thank you for giving us the opportunity to share our views with the Committee.

**BRIEFING**

**PROPOSED FINAL JUDGMENT IN**

***U.S. v. MICROSOFT***

*December, 2001*

## STATUS OF THE CASE

The U.S. Government and approximately half of the litigating states have decided to settle the case with Microsoft on terms the software industry views as inadequate under the standards for relief under decades of antitrust precedent. Nine states plus the District of Columbia have chosen to move forward with a hearing on remedy. Discovery is underway for that hearing and witness lists are currently being prepared for a trial set to commence in early March.

Pursuant to the District Court's order, the United States must simultaneously submit the settlement under the Antitrust Procedures and Penalties Act, which is described below.

### *THE TUNNEY ACT*

The Tunney Act, formally known as the Antitrust Procedures and Penalties Act, was originally introduced by Senator John Tunney in September, 1972, and was signed into law by President Ford on December 21, 1974. The relevant sections of the Tunney Act<sup>1</sup> were passed in part as a reaction to the scandal that erupted after the government settled its antitrust investigation of ITT (on grounds very favorable to the defendant), and it was discovered that ITT had lobbied extensively and engaged in secret negotiations to pressure the Department of Justice to agree to that settlement.<sup>2</sup>

Microsoft has made *no secret* of the political influence it has sought to create during this trial. Its political contributions, lobbying, grassroots, and public relations efforts are unprecedented and well documented.<sup>3</sup> Some might say there is an *obvious and direct*

<sup>1</sup> The Tunney Act also made certain antitrust violations felonies, rather than misdemeanors; increased the available penalties a court could impose; and instituted a variety of procedural reforms designed to expedite the trial and appeal of government antitrust cases.

<sup>2</sup> See Kintner, Federal Antitrust Law § 40.25 at 208 n.721; 5 Von Kalinowski et al., Antitrust Laws and Trade Regulation 2d §96.03[1] at 96-12 n.4.

<sup>3</sup> "Microsoft Targets Funding for Antitrust Office." Dan Morgan and Juliet Eilperin. Washington Post October 15, 1999. "Pro-Microsoft lobbying to limit antitrust funding irks top lawmakers." The Wall Street Journal October 15, 1999. "Microsoft Paid For Ads Against DoJ Case." Madeleine Acev. TechWeb September 20, 1999. "Microsoft Paid For Ads Backing Its Trial Position." David Bank. The Wall Street Journal September 20, 1999. "Microsoft Paid For Ads Backing It In Trial." Seattle Times September 19, 1999. "Pro-Microsoft Ads Were Funded by Software Giant." Greg Miller. Los Angeles Times September 18, 1999. "Microsoft Paid for Ads About Trial." Associated Press September 18, 1999. "Microsoft Covered Cost of Ads Backing It in Antitrust Suit." Joel Brinkley. New York Times September 18, 1999. "Rivals fear Microsoft will cut a deal." John Hendren. The Seattle Times June 21, 2001. "Bush's Warning: Don't Assume Favors Are Due." Gerald F. Seib The Wall Street Journal January 17, 2001. "Bounty Payments are offered for pro- Microsoft letters and calls." The Wall Street Journal October 20, 2000. "Microsoft is Source of 'Soft Money' Funds Behind Ads in Michigan's Senate Race." John R. Wilke. The Wall Street Journal October 16, 2000. "Microsoft leans creatively on levers of political power as breakup decision looms, 'stealth' lobbying efforts aim for survival." Jim Drinkard and Owen Ulmann. USA Today May 30, 2000. "Microsoft's All-Out Counterattack." Dan Carney, Amy Borrus and Jay Greene. BusinessWeek May 15, 2000. "Aggressiveness: It's Part of Their DNA." Jay Greene, Peter Burrows and Jim Kerstetter. BusinessWeek May 15, 2000. "The Unseemly Campaign of Microsoft." Mike France. Business Week April 24, 2000. "Microsoft's Lobbying Abuses." Editorial. New York Times November 1, 1999. "Awaiting Verdict. Microsoft Starts Lobbying Campaign." Joel Brinkley. New York Times November 1, 1999. "Microsoft Seeks Help Of Holders." John R. Wilke. The Wall Street Journal November 1, 1999.



*causal connection* between these activities and the weak nature of the proposed settlement, proving if nothing else that the public policy concerns that spawned the Tunney Act in the first place have been validated. Judge Kollar-Kotelly will be charged with the responsibility of determining the extent to which the public interest has been affected by the unprecedented politicization of this law enforcement matter.

As the Senate Report that accompanied the Tunney Act explained, “[t]he primary focus of the Department [of Justice]’s enforcement policy should be to obtain a judgment — either litigated or consensual — which protects the public by insuring healthy competition in the future.” While Congress did not want to discourage settlement of antitrust litigation — significantly more than half of government antitrust suits are settled — it determined that judges should independently review all settlement agreements, with adequate involvement by the public and others in the relevant industry, before entering a consent judgment.

Under the Tunney Act, the United States needs to publicize the settlement agreement, invite and respond to public and industry comments on the details of that agreement, and defend the agreement in court — where the judge by statute would need to determine independently that the agreement was in the “public interest.”

Even though Judge Kollar-Kotelly urged both sides to settle the case, the goal of any settlement must be to achieve the public interest objectives of the lawsuit more efficiently and with more certainty that the litigation process. *Merely achieving an end* to the litigation, and thus rewarding Microsoft for its intransigence over the years is *not a legitimate goal*, nor should it play any part in settlement analysis.

In fact, the standards for review under the Tunney Act are *substantially higher in this case* than in typical Tunney Act cases. That is because there has never been a settlement — and therefore Tunney Act review — of an antitrust case that has been affirmed by an Appeals Court. Since there is no longer any litigation risk — or question about liability or the strength of the government’s case the only appropriate interpretation of the “public interest” is in the context of the standards set forth by the Court of Appeals.

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“Microsoft’s Bad Lobbying.” Editorial. Washington Post October 24, 1999. “Microsoft Attempt To Cut Justice Funding Draws Fire.” David Lawsky. Reuters October 17, 1999. “Microsoft Targets Funding for Antitrust Office.” Dan Morgan and Juliet Eilperin. Washington Post October 15, 1999. “Pro-Microsoft lobbying to limit antitrust funding irks top lawmakers.” The Wall Street Journal October 15, 1999. “Microsoft Paid For Ads Against DoJ Case.” Madeleine Acev. TechWeb September 20, 1999. “Microsoft Paid For Ads Backing Its Trial Position.” David Bank. The Wall Street Journal September 20, 1999. “Microsoft Paid For Ads Backing It In Trial.” Seattle Times September 19, 1999. “Pro-Microsoft Ads Were Funded by Software Giant.” Greg Miller. Los Angeles Times September 18, 1999. “Microsoft Paid for Ads About Trial.” Associated Press September 18, 1999. “Microsoft Covered Cost of Ads Backing It in Antitrust Suit.” Joel Brinklev. New York Times September 18, 1999.

## ***SUMMARY OF THE WEAKNESSES OF THE PFJ's***

In the sections following we discuss – provision-by-provision – weaknesses in the Proposed Final Judgment. In this section, we focus on the *more important issues* of what *is not included* in the settlement in the first place.

### *Remedy Ignores Clear Guidance of Court of Appeals*

The central issue with the proposed remedy is its *fundamental failure* to meet the standards so clearly set forth by the Court of Appeals. Rather, the Department of Justice has articulated a view that all it must do is create a narrow set of remedies, which merely prevents Microsoft from engaging in the precise types of unlawful conduct against new competitive threats in the future. This view ignores the fact that unrestrained monopolists are likely to engage in new, creative forms of predation, which is why the Supreme Court has admonished the Department of Justice to “close the untraveled roads to monopolization, not just the traveled roads.”

More troubling, the Department *ignores the fact* that competitive threats to Microsoft's monopoly *do not appear with regularity*. In fact, the dual threats of Netscape's Navigator browser and Sun's Java programming language – propelled by the Internet boom – may well be *once in a lifetime* competitive events. That is one of many important reasons why it is particularly inappropriate for the Department of Justice to allow Microsoft to keep all the “fruits” of its unlawful activity without any regard for the competitive impact on the industry or consumers.

Most industry observers have sadly reached the conclusion that the Department of Justice was prepared and eager to settle this case at any price. If permitted to stand, antitrust law enforcement in the high-technology industry – which many have described as the sector that now drives the economy – *will be effectively repealed*. Future antitrust defendants will follow the yellow brick road paved by Microsoft: deny that you are a monopoly regardless of the court findings, outlast and outspending your governmental adversaries and trust that sooner or later, the government will accept a meaningless settlement primary for the sake of settlement alone.

It is the responsibility of the Justice Department *not* to lose interest in enforcing the laws necessary to insuring competition and consumer choice. Settling on the cheap the most important antitrust case in a generation in the most important industry in America is an unwarranted abdication of responsibility. *If permitted to stand, consumers will pay the price for generations to come in the form of diminished choices, higher prices, and stifled innovation.*

### *No Remedy for the Browser or Java*

The DoJ remedy is inadequate in the area of so-called “middleware.” “Middleware” is a critical concept in this case because middleware is the software layer that – in a competitive market – could undermine Microsoft's ability to protect its monopoly. Both

Netscape's Navigator and the Java programming language were examples of middleware threats, yet the Proposed Final Judgment is *silent* on both the Browser and Java. These middleware and platform threats were the *central focus* of the appeals court decision. It is *insupportable to settle* for a remedy that the Department of Justice knows will not have any competitive impact in the central markets at issue in the case.

#### *Remedy Relies too Heavily on PC Companies (OEMs)*

As a general matter, the middleware – and other remedies – imposed by the Department of Justice relies far too heavily on PC companies exercising flexibility in product design, rather than affirmatively requiring Microsoft to comply with the antitrust laws. It is possible – in fact, likely – to imagine a result where the PC companies choose *not* to exercise their new rights under a settlement. As a practical matter, *that would leave the government with no remedy* for the most important parts of the Appeals Court's ruling.

It is inappropriate for the government to impose – *transfer* – its remedial obligations under the antitrust laws to PC companies, which are wholly dependent upon the monopolist. The DoJ seems more willing to impose the burden of forcing Microsoft to comply with the antitrust laws on PC companies rather than impose even the slightest restrictions on Microsoft – the adjudicated monopolist – to change the way *it* does business. *As both an economic and a practical matter, the PFJ imposes greater burdens on PC companies than it does on the adjudicated monopolist.*

#### *Remedy Ignores Key Finding of the U.S. Court of Appeals*

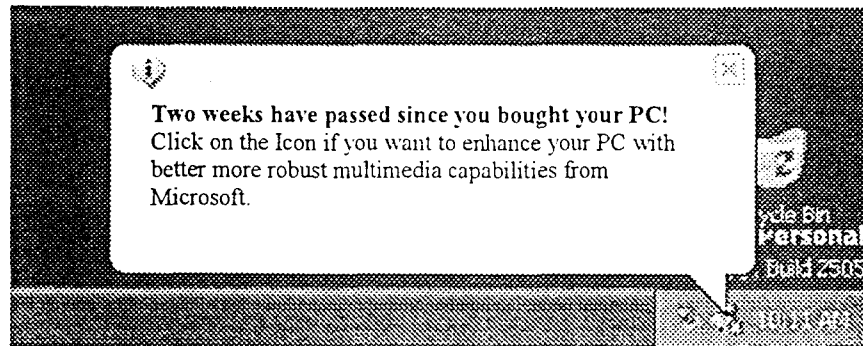
Nothing in the agreement prohibits Microsoft's "commingling of code" or binding of its middleware to the OS. This was a major issue in the case; the Court of Appeals specifically found Microsoft's commingling of browser and OS code to be unlawful. Microsoft petitioned the Appeals Court for a rehearing on this precise matter, which was *summarily rejected by the court*. And yet, after the Court clearly ruled on the rehearing, the DOJ adopts Microsoft's view – not the Courts. The settlement would explicitly permit Microsoft's commingling of code to continue.

The danger of the absence of this provision is reinforced by what is found in the definition "U," stating that the definition of what code comprises a Windows Operating System Product "shall be determined by Microsoft in its sole discretion." Thus, Microsoft can, over time, render all the protections for middleware meaningless, by binding and commingling code, and redefining the OS to include the bound/commingled applications.

#### *Remedy "Requires" or "Mandates" Microsoft to Continue Business As Usual*

Two of the key provisions of the PFJ cited by DOJ as instrumental in restoring competition *merely require Microsoft continue to engage in business as usual*. First, DOJ points to the provision that allows PC companies and end users to remove "end user access" to Microsoft middleware (i.e. Internet Explorer, Windows Media Player,

Windows Messenger, etc). It is important to understand that all “end user access” really means is the ability to remove the “icon” for the middleware application, not the middleware itself. Second, DOJ “grants” the PC companies “flexibility” to add or remove icons on the Windows desktop. On both points, it is apparently convenient for DOJ and Microsoft to forget that most of this flexibility either previously existed or was granted by Microsoft five months before the settlement on July 11<sup>th</sup> (see appendix one). Moreover, PC companies have always enjoyed the flexibility to add icons to the Windows desktop. Amazingly, the PFJ actually makes matters worse because it grants Microsoft the right to come back 14 days after a consumer buys a PC and – after confirmation from the user – automatically deletes all the changes a PC company made and restores the Microsoft software. You can imagine the prompt now:



So, under this remedy, Microsoft gets to undermine the choices made by PC companies and grants Microsoft a “second bite at the apple” to badger consumers into -- unknowingly or unwittingly -- switching back to Microsoft’s software.

Second, DOJ claims credit for “*requiring*” Microsoft to disclose to third party software developers the Applications Programming Interfaces (APIs) for Windows. A review of the definitions reveals that the provision is essentially meaningless. The API disclosure requirements for new versions of the Windows operating systems must be disclosed in a “timely manner.” A close examination of the definition of “timely manner,” exposes that this requirement is triggered when Microsoft distributes beta copies of its software to 150,000 “beta testers.” Microsoft can be expected to insure that the number of beta testers remains below 150,000, thus exempting itself from the disclosure requirements in the first place. More telling is the fact that Microsoft never ever had 150,000 “beta testers” for Windows XP, Windows ’98, or Windows ’95.

But astonishingly, DOJ apparently did not make the effort to learn that Microsoft discloses information to third party software developers anyway, through a program called the Microsoft Developers Network (MSDN) (see <http://www.msdn.microsoft.com>). The MSDN program is “an essential resource for developers using Microsoft tools, products, and technologies. It contains a bounty of technical programming information, including sample code, documentation, technical articles, and reference guides.” Why does Microsoft give out this information? Because the most important economic law of the software industry is that the more programs you

have running on your platform (like Windows) the more valuable your platform is relative to competitors. So, the more applications Microsoft has running on Windows, the more valuable Windows becomes.

In the spring of 1995, Netscape requested from Microsoft the APIs necessary to insure that its browser would work with the Windows '95, scheduled for later that year. Microsoft resisted sharing this information for nearly a year, until well after Windows '95 was released. Because Windows '95 did not involve 150,000 beta testers, Netscape would not have had the right to receive the critical APIs if this remedy had been in place in 1995. Thus Microsoft's ability to arbitrarily withhold APIs from those that would deign to enter into competition with Windows is left intact.

### *Remedy Ignores Fundamental Economics of the Software Industry*

The more developers that support Windows, the more valuable Windows becomes. That is the fundamental economic reality of the industry. That is also why the "flexibility" to remove "end user access" to Microsoft's applications is so woefully inadequate. The fact is that under this remedy, regardless of whether consumers or PC companies affirmatively decide to remove a particular Microsoft middleware application (i.e. browsers, media player, instant messenger, e-mail, etc.) DOJ's remedy permits *all of the code to remain*. The impact of this decision is the third party developers will *always* write software to the middleware platform that is present on the largest number of PCs. Under the PFJ, that middleware will always be Microsoft's middleware and non-Microsoft's middleware threats will never have a chance at attracting a large enough developer following to displace Windows. In response to a question about this precise issue in the Wall Street Journal, Charles James responded, "I don't care." (check either Nov. 11 or 12 WSJ).

### *Remedy is Unenforceable and Riddled with Loopholes*

In addition, too many of the provisions require a mini-retrial to be enforced. In numerous places throughout Section III, the limitations on Microsoft's conduct are basically rephrased versions of the Rule of Reason. In other words, the constraints on Microsoft (once the exceptions are taken into account) devolve into a mandate that Microsoft act "reasonably." For example, in III.F.2, Microsoft may place enter into restrictive agreements with ISV's activities if they are "reasonably necessary." Likewise, the Joint Venture provisions found in III.G. also "reasonably necessary" test.

Aside from the obvious concern about Microsoft's willingness to do so given its track record, this formulation is problematic for two other reasons. First, it does little more than restate existing antitrust law (such provisions cannot be said to be "remedial" if they, in essence, are merely directives to refrain from future illegal acts). And second, in terms of enforcement, alleged violations of such "be reasonable" provisions can only be arrested through proceedings that will become, in essence, mini-retrials of *U.S. v. Microsoft* itself.

Moreover, the proposed remedy follows timelines that are too loose and too generous to a company with the engineering resources and product-update capabilities of Microsoft. Microsoft is given almost a year before making even the most modest changes. For example, the “icon” remedy discussed above merely requires Microsoft to allow PC companies and end users to remove the icon for particular programs from the Windows desktop. This functionality is readily available in Windows today. But even the more significant step of including the “icon” in the “add / remove” utility would require a trivial degree of engineering. Yet Microsoft is given a year – 20 percent of the term of the decree – to implement even this rudimentary changes. Microsoft won the “Browser War” in less than a year.

### *The Devil is in the Definitions*

There are literally dozens of provisions that sound promising until the definitions reveal that in fact Microsoft has sole discretion to determine whether or not the provisions are triggered at all. Just a few obvious examples:

As discussed above, the API disclosure requirements for new versions of the Windows operating systems are triggered only when Microsoft distributes beta copies of its software to 150,000 “beta testers.” Microsoft can be certain to stop beta distribution well before those unprecedented number of testers receive beta copies in the first place. And even if Microsoft accidentally distributed 150,000 beta versions of Windows, the term “beta tester” is not defined anyway, giving Microsoft yet another obvious way to evade the disclosure provisions – which again are being touted as the centerpiece of the agreement.

Probably the most gratuitous provision comes at the last line of the PFJ. Definition “U” of the Windows Operating System Product definition, states: “The software code that comprises a Windows Operating System Product shall be determined by Microsoft in its sole discretion.” This language, of course, has no practical import for the purposes of the PFJ except that it lets Microsoft evade many of the settlements provisions. It also strikes most observers as odd that an antitrust decree grants explicitly grants complete latitude to the defendant and seems to provide Microsoft with a judicially approved monopoly over the most important distribution channel in the software industry: Windows.

## ***SECTION-BY-SECTION ANALYSIS OF THE PFJ***

Some obvious problems with the agreement are discernable immediately. Below, we identify the most unsettling of those problems. Perhaps some are not in fact problems, but merely questions of misreading of the agreement; of course, the fact that reasonable people can read the agreement differently is itself indicative of the problem presented by it, given that Microsoft will surely interpret it as a determined and unrepentant monopolist.

### **A. Retaliation**

#### *The Scope of the Protection is Narrow:*

Most significantly, Microsoft is constrained only from the specified forms of retaliation. If it retaliates against a PC company for any non-specified reason, that retaliation is not prohibited. This formulation is particularly problematic because the protected PC company activities are narrowly and specifically defined. Retaliation against a PC company for installing a non-Microsoft application that does not meet the middleware definition is NOT prohibited; nor is retaliation against a PC company for removing a MSFT application that does not meet the middleware definition.

For example:

- MSN and MSN Messenger are not middleware under the definition of a Microsoft Middleware Product. If a PC removes the icon and start menu promotion of MSN and/or MSN Messenger, it can be subjected to retaliation.
- Windows Movie Maker or the Windows photo editing software is not middleware so if a PC company decides to remove either of these products, Microsoft can retaliate.

More generally, it is odd to have a formulation that de facto approves of Microsoft's retaliation against PC companies, except where that retaliation is forbidden. And, it is odd that any certain types of retaliation (i.e., retaliation by changing contractual relations and retaliation by changing promotional arrangements) are forbidden, as opposed to prohibiting any form of retaliation whatsoever.

#### *Non-Monetary Compensation Provision is Far too Narrow*

Microsoft is free to retaliate against PC companies that promote competition by withholding any existing form of "non-monetary Compensation" – only "newly introduced forms of non-monetary Consideration" may not be withheld.

#### *Termination Clause Will Intimidate PC companies*

Microsoft can terminate, without notice, a PC companies Windows license, after sending the PC company two notices that it believes it is violating its license. There need not be any adjudication or determination by any independent tribunal that Microsoft's claims are correct; only two notices to any PC company of a putative violation, and thereafter, Microsoft may terminate *without even giving notice*. This provision means that the PC companies are, at any time, just two registered letters away from an unannounced economic calamity. It will render the PC companies severely limited in their willingness to promote products that compete with Microsoft.

#### *Pricing Schemes Will Allow Microsoft to Avoid Effect of Decree*

Microsoft can price Windows at a high price, and then put economic pressure on the PC company to use only Microsoft applications through the provision that Microsoft can provide unlimited consideration to PC companies for distributing or promoting Microsoft's services or products. The limitation that these payments must be "commensurate with the absolute level or amount of" PC company expenditures is hollow – given that it is not clear how the PC companies costs will be accounted for, for this purpose.

#### **B. Pricing**

##### *Microsoft Can Use Rebates to Eviscerate Competition*

Under the settlement, Microsoft can provide unlimited "market development allowances, programs, or other discounts in connection with Windows Operating System Products." This provision essentially eviscerates the entire scheme of PC company choice, functioning the same way as the rebate provision discussed above, but without any tether or limiting principle whatsoever. Simply put, MSFT can charge \$150 per copy of Windows, but then provide a \$99 "market development allowance" for PC companies that install Windows Media Player as opposed to Real Networks media player.

Presumably, this is intend to be prescribed by III.B.3.c, which provides that "discounts or their award" shall not be "based on or impose any criterion or requirement that is otherwise inconsistent with ... this Final Judgment," but this circular and self-referential provision does not ensure that the practice identified above is prohibited.

#### **C. PC Company Licenses**

##### *Microsoft Retains Control of Desktop Innovation*

Microsoft retains control of desktop innovation, by being able to prohibit PC companies from installing or displaying icons or other shortcuts to non-Microsoft software/products/services, if Microsoft does not provide the same software/product/service. For example, if Microsoft does not include a media player shortcut inside its "My Music" folder, it can forbid the PC companies from doing the



same. This turns innovation and the premise that PC companies be permitted to differentiate their products on its head.

- For example, Sony – as a PC company and a major force in the music and photography industries – would be uniquely positioned to differentiate the “My Music” and “My Photos” folder. And yet, Sony’s ability to do turns solely on the extent to which Microsoft chooses to unleash competition in these areas.

#### *Microsoft Retains Control of Desktop Promotion:*

Microsoft also, very oddly, can control the extent to which non-Microsoft middleware is promoted on the desktop, by virtue of a limitation that PC companies can promote such software at the conclusion of a boot sequence or an Internet hook-up, via a user interface that is “of similar size and shape to the user interface provided by the corresponding Microsoft middleware.” Thus, Microsoft sets the parameters for competition and user interface.

#### *Promotional Flexibility for Internet Access Providers Only, and Only for the PC companies “own” Internet Access Provider (IAP)*

PC companies are allowed to offer IAP promotions at the end of the boot sequence, but not promotions for other products. Also, the phrase that defines the scope of this flexibility (a PC companies “own IAP offer”) is ambiguous: it is not clear if the PC companies right is limited to offering an IAP product that is marketed under the PC companies brand, or if this includes any IAP that an PC company may reach an agreement with to promote in this space. The latter would obviously give the PC companies more flexibility.

### **D. API Disclosure**

#### *APIs Defined Too Narrowly*

Microsoft can evade this provision by “hard-wiring” links to its applications, and through other predatory coding schemes. The disclosure is limited to “APIs and related Documentation.” This may be too narrow and can be evaded. Moreover, the provision for the disclosure of “Technical Information” found in Judge Jackson’s interim conduct remedies has been eliminated. These disclosures are necessary to provide effective interoperability.

### **E. Server Interoperability Issues (also found in III, E, I, H and J)**

#### *Only Full Interoperability Can Reduce Microsoft's Barriers to Desktop Competition*

The DOJ's proposed server remedy will fail to provide meaningful, competitive interoperability between Microsoft desktops and non-Microsoft servers.

The applications barrier to entry is central to this case and to Microsoft's desktop monopoly. A remedy that provides true server interoperability can be a powerful tool to reduce the applications barrier to entry. The server has the same, or indeed more, potential to provide an alternative application platform to the desktop as did the browser or any other desktop runtime. In that sense it is directly analogous to middleware products.

Microsoft has plainly recognized the threat that non-Microsoft servers pose as an alternative applications platform and has acted to exclude those products from full interoperation with the desktop and to advantage its own server products. It is able to do that because it controls the means by which servers may interoperate with the functions and features of the Windows desktop. In order to succeed in establishing non-Microsoft servers as an effective alternative application platform, both consumers and application developers have to be convinced that such servers can overcome the interoperability barriers that Microsoft has erected and have become viable alternatives to Microsoft's own servers, which of course fully interoperate with the desktop.

The proposed decree allows Microsoft to continue to exploit dependencies between its desktop applications or its desktop Middleware and its servers or handheld devices to exclude server and handheld competition.

#### *The New Order Requires Less Disclosure Than the Original Order*

The interim conduct order imposed by Judge Jackson (see Final Judgment Section 3(b)(iii)) required Microsoft to disclose all APIs, Communications Interfaces and Technical Information (i.e., any and all possible technical dependencies) between (a) software installed on any device (including servers and handhelds) and (b) any Microsoft Operating System or Middleware installed on a PC.

But the Proposed Final Judgment discloses less information (no server APIs and no Technical Information) between fewer platforms (no client OS-to-server application disclosure; no unbundled client Middleware-to-server disclosure; no client OS-to-handheld disclosure; and no client Middleware-to-handheld disclosure; with no access to source code, and no provision for timely or updated disclosures.

Consequently, unlike old 3(b)(iii), the PFJ (Section 3(E)) permits Microsoft to push functionality from the OS to the application layer in order to avoid disclosure.

#### *The Failure to Define "Interoperate" Is A Huge Mistake*

Neither section 3(E) nor any other provision of the proposal defines the meaning of "interoperate." The failure to define "interoperate" is tantamount to the Justice Department's prior failure to define "integrate" in the 1995 consent decree, and will form the basis for unending and bitter future disputes over the scope of Microsoft's disclosure obligation.

*"Communications Protocol" is Defined Too Narrowly and Too Ambiguous*

The definition of "Communications Protocol," which determines the scope of server information to be disclosed by Microsoft, is highly ambiguous, and potentially very narrow in scope:

It is limited to Windows Server Operating System, and thus is unclear whether it includes Internet Information Server (Microsoft's Web Server) or Windows Media Server, both of which are shipped with Windows 2000 Server.

It is unclear whether "rules for information exchange" that "govern the format, semantics, timing sequencing, and error control of messages exchanged over a network" means the rules for transmitting information packets over a network, or the rules for formatting and interpreting information within such packets.

It is unclear what the last sentence of the definition of Communication Protocol means when it excludes from the information to be disclosed "protocols to remotely administer Windows 2000 Server and its successors."

Even in its broadest possible meaning, Communications Protocols is insufficiently broad or comprehensive to require disclosure of the information needed to permit interoperability between non-Microsoft servers and the full features and functions of Windows desktops. For example, no conceivable interpretation of Communications Protocol would appear to require disclosure of Microsoft's COM+.

*The Definition of "Windows Operating System Product" Gives Microsoft the Ability to Avoid Disclosure*

The scope of Microsoft's disclosure obligation is determined in large part by the meaning of "Windows Operating System Product." The definition of Windows Operating System Product leaves Microsoft free to determine in "its sole discretion" what software code comprises a "Windows Operating System Product." In other words, Microsoft's disclosure obligation is subject entirely to its discretion.

*The Room for Dispute Means No Meaningful Disclosure is Likely to Occur Much Before the Judgment Expires:*

The ambiguities and uncertainties in the scope and meaning of section 3(E) and the definitions on which it depends means that a protracted battle will inevitably be required to obtain Microsoft's full compliance with its disclosure obligations. The 9 month delay in Microsoft's obligation to begin disclosure means that a significant portion of the 5 year remedial term will have expired, and that one product generation at least will have passed, before any disclosure is made. Combined with the fact that there is no explicit provision for additional disclosures for upgraded or successor products, and no requirement for timely disclosure, means that there is not likely to be more than one disclosure for one product generation only.

Microsoft's ability to exploit ambiguity, and the discretionary powers given to the company, the defendant here, must be eliminated. The document simply fails the test of clarity and specificity needed to be a meaningful contract between the United States, the state plaintiffs, and Microsoft.

#### *Section 3(J)'s Carve Out Eliminates The Most Important Disclosures*

What little section 3(E) provides, section 3(J) takes away by permitting Microsoft to refuse to disclose the very protocols and technical dependencies it is currently using to prevent non-Microsoft servers from interoperating with Microsoft desktops and servers.

### **G. Anti-Competitive Agreements**

#### *Joint Development Agreements Can Subvert Protections of Settlement*

The protection against anti-competitive agreements is substantially undermined by the exception that allows Microsoft to launch "joint development or joint services arrangements" with PC companies and others. Under this provision, Microsoft can "invite" PC companies, ISVs, and other industry players to enter into "joint development" agreements, and then resort to an array of exclusionary practices.

- For example, Microsoft invites PC company X to form a "joint development" project to create "Windows for X," a "new product" to be installed on the PC company's PCs. So long as Microsoft's activities are cloaked under this rubric, it is exempt from the ban on requiring the PC company to ship a fixed percentage of its units loaded with Microsoft's applications, and other protections designed to promote competition.

### **H. Desktop Customization**

#### *Add/Remove is For Icons Only, Not the Middleware Itself*

The add/remove provisions in the agreement only allow for removal of end user access to Microsoft middleware, not the middleware itself. This position is not consistent with the language in the Court of Appeals opinion on commingling or the "add/remove" issue.

- For example, a PC company or a consumer might choose to eliminate Microsoft's Internet Explorer and replace it with Netscape's Navigator as the default. Under this provision, Microsoft's Internet Explorer – not Netscape's Navigator – is still used in the MyDocuments, MyMusic, MyPictures and Windows Explorer folders.

More substantially, if MSFT's middleware remains on PCs (even with the end user access masked), then applications developers will continue to write applications that run on that middleware – reinforcing the applications barrier to entry that was at the heart of

this case. Allowing MSFT to forbid the PC companies from removing MSFT middleware, and allowing MSFT to configure Windows to make it impossible for end users to do the same, allows Microsoft to reinforce the applications barrier to entry, irremediably.

As we have seen with the implementation of this approach (i.e., icon removal only) with regard to Internet Explorer in Windows XP, MSFT can use the presentation of this option in the utility to make it less desirable to end users.

Moreover, limiting the required “add/remove” provision to icons only is actually a step backward from the current state of affairs in Windows XP, where code is removable for several pieces of Microsoft middleware. Thus, the DoJ actually codifies the most limiting of consumer alternatives – merely removing an icon.

#### *Why Are Non-MSFT Icons Subject to Add/Remove?*

The agreement gives Microsoft an added benefit: it can demand that PC companies include icons for non-MSFT middleware in the add/remove utility. Why this should be required, in the absence of any finding that assuring the permanence of non-MSFT middleware on the desktop is anti-competitive, is bizarre. This essentially treats the victims of Microsoft’s anti-competitive behavior as if they were equally guilty of wrongdoing.

#### *Twelve Months To Implement is Too Long*

Most of the provisions in this section do not take effect for a full 12-month period – 20 percent of the total length of the PFJ. Given Microsoft’s vast engineering resources; an ability to instantly update its products via on-line downloads; and the just-in-time manufacturing of the PC companies, there is no justification for this lengthy phase-in. Tellingly, when Microsoft made modest concessions in response to the Court of Appeals decision on July 11th, it implemented these changes within three weeks (when a new beta version of Win XP was released). Consumers should not have to wait another year for the choices they deserved to be offered years and years ago.

#### *Microsoft Can Embed Middleware, And Evade Restrictions*

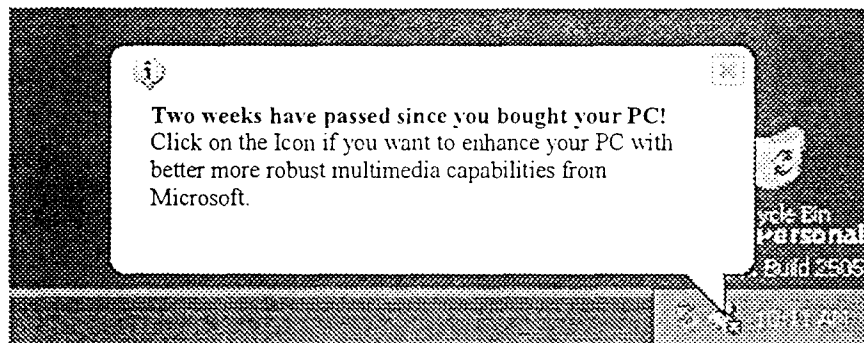
End users and PC companies are allowed to substitute the launch of a non-Microsoft Middleware product for the launch of Microsoft middleware only where that Microsoft middleware would be launched in a separate Top-Level Window and display a complete end user interface or a trademark. This, in essence, allows Microsoft to determine which middleware components will or will not be subject to effective competition. By embedding their middleware components in other middleware (and thereby not displaying it in a “Top Level Window” with all user interface elements), or by not branding the middleware with a trademark, Microsoft can essentially stop rivals from launching their products in lieu of the Microsoft products.

### *Harder for Consumers to Choose Non-Microsoft Products than Microsoft Products*

In the same provision (III.H.2.), Microsoft may require an end user to confirm his/her choice of a non-Microsoft product, but there is no similar “double consent” requirement for Microsoft Middleware. There is no reason why it should be harder for users to select non-Microsoft products than Microsoft products.

### *Microsoft Can “Sweep” the Desktop, Eliminate Rival Icons*

Additionally, the PC company flexibility provisions are substantially undermined by a provision that allows Microsoft to exploit its “desktop sweeper” to eliminate PC company installed icons by asking an end user if he/she wants the PC company-installed configuration wiped out after 14 days. Thus, the PC company flexibility provisions will only last on the desktop with certainty for 14 days, and after that period, persistent automated queries from Microsoft can reverse the effect of the PC company’s installations. The effect of this provision is to severely devalue the ability of PC companies to offer premier desktop space to ISVs – and to undermine the ability of PC companies to differentiate their products and provide consumers with real choices. Here is an example of what a prompt might look like (which would have the effect of setting all of the choices and defaults previously picked by PC companies and consumers back to Microsoft’s presets):



### *Desktop “MFN” Requirements*

Finally, nothing in the decree forbids Microsoft from requiring – especially where non-middleware is concerned – so-called MFN agreements from the PC companies. These agreements tax PC company efforts to promote Microsoft rivals by requiring that equal promotion or placement be given to Microsoft products, often without compensation.

## **I. Licensing Provisions**

### *Licenses Put in Hands of Those Who May Not Be Able to Use Them*

The PC company licensing provision is limited in its effectiveness because the PC companies are prevented from “assigning, transferring, or sublicensing” their rights. This

may severely limit their ability to partner with software companies to develop innovative software packages to be pre-installed on PCs. This provision is especially harmful when contrasted with the broad partnering opportunities afforded to Microsoft under III.G. In addition, the PC company's willingness to use these provisions – even if they have the financial and technical wherewithal to do so – may be limited by the weakness of the retaliation provisions discussed above.

*Reciprocal License? This simply can't be true.*

The agreement **requires** ISVs, PC companies and other licensees to license back to Microsoft any intellectual property they develop in the course of exercising their rights under the settlement. But that simply **rewards Microsoft** for having created the circumstances (i.e., having acted illegally) that necessitated the settlement in the first place. Microsoft should not be able to obtain the intellectual property rights of others simply because those law abiding entities have been required to work with this law breaker.

In addition, this provision may inadvertently work as a “poison pill” to discourage ISVs, et al., from taking advantage of the licensing rights ostensibly provided them in III.I. The **risk** that an ISV would **have to license** its rights **to Microsoft** will be a substantial deterrent for that ISV from exercising its rights under III.I.

#### J. “Security and Anti-Piracy” Exception to API Disclosure

*The Settlement Exempts The Software and Services That Are the Future of Computing*

One of the most seemingly innocuous provisions in the agreement – that is in fact, one of the biggest loopholes – is the provision that allows MSFT to withhold from API, documentation or communication protocol disclosure any information that would “compromise the security of ....digital rights management, encryption or authentication systems.” The fact is that for programs to interoperate you must have **all** the information necessary. A provision that allows Microsoft to withhold **certain** information – or guarantees litigation over what information is exempted ensures that no program will **ever be truly interoperable**. This provision raises several critical concerns:

*Digital Rights Management Exception “Swallows” Media Player Rule*

Since the most prevalent use of media players in the years ahead will be in playing content that is protected by digital rights management (DRM) (i.e., copyrighted content licensed to users on a “pay-for-play” basis), allowing MSFT to render its DRM solution non-interoperable with other DRM solutions essentially means that non-Microsoft media players will be virtually useless when loaded on Windows computers.

*Authentication Exception Allows Microsoft to Control Internet Gateways, Server-Based Services*

Most experts agree that the future of computing lies with server-based applications that consumers will access from a variety of devices. Indeed, Microsoft's ".Net" and ".Net My Services" (formerly known as Hailstorm) are evidence that Microsoft certainly holds this belief. These services, when linked with MSFT's "Passport," are Microsoft's self-declared effort to migrate its franchise from the desktop to the Internet.

By exempting authentication APIs and protocols from the settlement's disclosure requirement, the settlement exempts the most important applications and services that will drive the computer industry over the next few years. If Microsoft can wall off Passport, .Net, and .Net MyServices (Hailstorm) with impunity – and link these internet/server-based applications and services to their desktop monopoly – then Microsoft will be in a commanding position to dominate the future of computing.



## ***PFJ SECTION IV. COMPLIANCE AND ENFORCEMENT***

### **A. Enforcement Authority**

#### ***Enforcement Authority is Too Difficult to Employ***

Clearly, what's missing from the agreement is a quick, meaningful, and empowered mechanism for preventing and rectifying Microsoft's future violations of the agreement. Thus, while the provision allowing Microsoft to cure any violations of III C, D, E, and H before an enforcement action may be brought is not itself objectionable, it is but one of a number of provisions that make enforcing the agreement cumbersome, expensive, and time consuming.

### **B. Technical Committee**

#### ***Microsoft gets half the votes.***

In setting up the Technical Committee, Microsoft gets to appoint one member, the Department of Justice gets to appoint one member, and Microsoft and the Department jointly appoint the third. This formulation guarantees that at least Microsoft, the defendant, will approve half of the Technical Committee's members.

#### ***Technical Committee's Investigation Allowed Only Limited Use***

The work of the Technical Committee *cannot* "be admitted in any enforcement proceeding before the Court for any purpose," and the members of the TC are forbidden to appear. Thus, under the terms of the decree, the substantial time, effort, and expense that can go into a TC process may need to be duplicated in an enforcement action – adding to the complexity and expense that process will pose for victims of Microsoft violations.

### **D. Voluntary Dispute Resolution**

#### ***Source Code Access is Not Enough***

While it is helpful that the Technical Committee will have access to MSFT's source code, and can resolve disputes involving that issue, the Technical Committee is otherwise powerless to compel Microsoft's compliance with the agreement in any other respect. The prospects that Microsoft will accept the decisions of the TC in a voluntary dispute resolution process are near zero. And the entire mechanism seems designed to drag disputes on indefinitely: no time limits or time lines are specified for dispute resolution.

Thus, as noted above, there must be some compulsory means of dispute resolution, short of renewed litigation in the District Court. As it stands now, a party injured by MSFT's violation of the decree can:

- Complain to the Technical Committee, which will then conduct an investigation;
- Once the investigation is complete, the TC will presumably issue some decision; while the investigation is ongoing, the TC is supposed to consult with MSFT's Compliance Officer, for an indefinite period;
- If the TC concludes that MSFT violated the agreement, and MSFT does not agree to change its behavior or rectify the wrong, then the TC must decide whether to recommend the matter to US DOJ for further action;
  - Once recommended, the U.S. DOJ – after some review period – may decide to take action, and apply to the court for a remedy, or it may not;
  - And once the US DOJ applies for action, the process in court to obtain relief or remedy may extend for an indefinite period.

This is obviously a lengthy and ineffective process for insuring that MSFT complies with its obligations under the decree. In an industry where time is of the essence, and where delays can be fatal, the delays built in that allow Microsoft to drag its feet are wholly unacceptable.

## ***PFJ SECTION V. TERMINATION***

### **A. Five Year Limit**

#### ***Five Year Coverage Is Inadequate***

Given the scope of Microsoft's violation, the time period required to restore effective competition, and the pattern of willful lawbreaking on Microsoft's part, a five-year consent decree is woefully inadequate.

### **B. Two Year Extension**

#### ***Penalty For Knowing Violations is Too Lenient***

Amazingly, the agreement provides that no matter *how many knowing and willful* violations that Microsoft engages in, the restrictions found in the settlement may be extended for a single two-year period only. Thus, if Microsoft is adjudged to have engaged in such a pattern of violations, it essentially has a "free reign" to repeat those violations with impunity. Moreover, even for a single adjudged instance of knowing and intentional violation, a mere two-year extension is inadequate.

## ***PFJ SECTION VI. DEFINITIONS***

### **A. APIs**

#### ***API Definition Too Narrow***

This is discussed above.

### **B. Communications Protocol**

#### ***Missing Definition, Inclusion of "Technical Information:"***

While the definition of communication protocol is adequate, the decree is missing a definition of "technical information," and inclusion of that material in the mandatory disclosures. This definition and protection were provided in the interim remedies entered by the District Court.

### **K. Microsoft Middleware Product**

#### ***Definition Exempts Too Much Middleware***

Much of the decree is based on this definition – the PC Company's flexibility turns on what is included or excluded from this category of application. And yet the definition is fatally flawed.

- First, among existing products, only the five listed items are "middleware." That means that highly similar items, such as MSN, MSN Messenger, MSN Explorer, MSFT RunTime (the replacement for the MSFT JVM), Passport, Outlook, and Office are ALL excluded from the definition of middleware. Why Windows Messenger should be covered, but MSN Messenger should be exempt; or why Internet Explorer should be covered, but MSN Explorer should be exempt, is a mystery.
- Any efforts by PC companies to remove these Microsoft applications may be met with retaliation; end users cannot remove these applications (or even their icons). This is a step backward from the status quo (even in Windows XP); it is a gaping hole.
- Second, the generic middleware definition, which applies only to new products, and therefore does not capture any product now in existence, allows MSFT to define which products are included or not, by virtue of MSFT's trademark and branding choices. Thus, so long as MSFT buries these products inside other applications, they are not independently middleware.

- Third, as suggested in the points above, the definition misses the future platform challenges to Microsoft's Windows monopoly: web-based services. These services should be specifically defined, and included in the class of protected middleware.

## **N. Non-Microsoft Middleware Product**

### *Only Developers With REALLY Big Garages Need Apply*

The competitive offerings protected by the decree are narrowly limited to offerings that fall within the definition of "Non-Microsoft Middleware Products." Again, as noted above, the guarantees of PC company flexibility, promotion, and end use choice apply only to these specified products, not to any other software applications.

And yet, sadly, this definition narrowly extends this protection only to applications "of which at least one million copies were distributed in the United States within the previous year." Thus, an innovator in his garage, creating a new form of middleware, to revolutionize the computer industry, has no protection from MSFT's rapacious ways until he can achieve the distribution of 1 million copies of his software. So much for the Silicon Valley myth....

Also, as noted above, "web based services" are not captured in this definition, notwithstanding their importance to future competition to the Windows OS.

## **R. Timely Manner**

### *Netscape, All Over Again*

Microsoft's obligation to disclose APIs and other materials needed to make applications interoperable with Windows in a "timely manner" is keyed off the definition of that term in Section R. But, Microsoft retains complete control over this timeline because the definition provides that Microsoft is under no obligation to engage in these disclosures until it distributes a version of the Windows OS to 150,000 beta testers. Thus, so long as MSFT restricts its beta testing program to 149,999 individuals until very late in the development process, it can effectively eviscerate the disclosure requirements.

More troubling, it appears that Microsoft must have mislead the Department of Justice. Our review of the available documentation shows, for example, that Microsoft had no more than 20,000 beta testers<sup>4</sup> for Windows XP (at least until very late in the release cycle); thus, had this provision been in place during the Windows XP release cycle, Microsoft would have been under no obligation to release APIs until just on the eve of product shipping.

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<sup>4</sup> Note that the number of "beta testers" will be much smaller than the number of "beta copies" of a product that is being prepared for release.

Slow disclosure of APIs is precisely how MSFT defeated Netscape's timely interoperability with Windows 95. Thus, in this way, not only is the decree inadequate to prevent future wrongdoing, it does not even redress proven illegal acts in the past.

**U. Windows Operating System Product – The rule which gives away the rest of the settlement.**

The entire settlement can really be defined by its final clause, definition U. of the Windows Operating System Product. This provision gives Microsoft the right to define the Windows Operating System Product in the following way: "The software code that comprises a Windows Operating System Product shall be determined by Microsoft in its sole discretion." This definition eviscerates most of the prior provisions of the PFJ (or at a minimum guarantees continued litigation of the meaning of the PFJ) will be rendered meaningless.

More important, it gratuitously gives Microsoft a free reign to trample through the antitrust laws by continually redefining its monopoly product as it sees fit. It is hard to imagine how DoJ agreed to this provision.

## *Appendix One: Microsoft Announces Greater OEM Flexibility for Windows.*

### **Microsoft Announces Greater OEM Flexibility for Windows**

#### **Changes Will Not Affect Oct. 25 Launch Date of Windows XP**

**REDMOND, Wash. -- July 11, 2001 --** Microsoft Corp. announced Wednesday that it is offering computer manufacturers greater flexibility in configuring desktop versions of the Microsoft® Windows® operating system in light of the recent ruling by the U.S. Court of Appeals for the District of Columbia. The company said the changes would not affect the Oct. 25 launch date of Windows XP.

"We recognize that some provisions in our existing Windows licenses have been ruled improper by the court, so we are providing computer manufacturers with greater flexibility and we are doing this immediately so that computer manufacturers can take advantage of them in planning for the upcoming release of Windows XP," said Steve Ballmer, CEO of Microsoft. "Windows XP represents a revolutionary step forward in personal computing, and computer manufacturers and consumers are looking forward to this product with great anticipation."

"This announcement does not take the place of settlement discussions with the government parties or any future steps in the legal process; however, we wanted to take immediate steps in light of the court's ruling. We are hopeful that we can work with the government parties on the issues that remain after the court's ruling," Ballmer added.

The appeals court ruled that certain provisions in Microsoft's licenses with PC manufacturers impaired the distribution of third-party Web browsers. Microsoft will now provide PC manufacturers with the following new flexibility:

- PC manufacturers will have the option to remove the Start menu entries and icons that provide end users with access to the Internet Explorer components of the operating system. Microsoft will include Internet Explorer in the Add/Remove programs feature in Windows XP.
- PC manufacturers will have the option to remove the Start menu entries and icons that provide end users with access to Internet Explorer from previous versions of Windows, including Windows 98, Windows 2000 and Windows Me.
- PC manufacturers will retain the option of putting icons directly onto the Windows desktop. Based on extensive customer usability studies, Microsoft had designed Windows XP to ship with a clean desktop and improved Start menu, but PC manufacturers will now have the option of continuing to place icons on the Windows desktop if they want to.
- Consumers will be able to use the Add-Remove Programs feature in Windows XP to remove end-user access to the Internet Explorer components of the operating system. Microsoft has always made it easy for consumers to delete the icons for Internet Explorer, but will now offer consumers this additional option in Windows XP.

Although some of these changes will require development work and testing for Windows XP, Microsoft said Wednesday it can complete the work and will be able to meet the date for worldwide launch on Oct. 25. Computer industry leaders today underscored the importance of the launch of Windows XP to the PC industry and consumers.

"We're very excited about the possibilities that Windows XP delivers to our customers," said Ted Waitt, co-founder and CEO of Gateway. "With this new flexibility, we're looking forward to taking Windows XP to the next level, tailoring technology to meet our customers' needs."

"Windows XP is an incredible step forward for end users and partners, unlocking the possibilities of the digital world," said Jim Allchin, group vice president for platforms at Microsoft. "Windows XP provides new opportunities for companies throughout the hardware and software industries, especially PC manufacturers that have worked closely with us to create the best experience for customers."

"We're excited about Windows XP and the positive impact it will have on our industry. As a strong partner for more than 15 years, Compaq has worked closely with Microsoft throughout the extensive development of Windows XP," said Mike Larson, senior vice president and general manager of the Access Business Group at Compaq. "We are setting a new standard for simple, dependable and efficient computing."

"Dell is excited about delivering Windows XP later this year," said Jim Totton, vice president of software for the Consumer Products Group at Dell. "Dell is always interested in what's best for its customers, and the new levels of performance, ease of use and customization will combine for a great personal computing experience." Windows XP will offer customers exciting new experiences for both home and work. Whether someone is an aspiring photographer or a businessperson on the road, Windows XP enables them to embrace the new digital world. It brings together the power and reliability that businesses have asked for with the ease of use and flexibility that home consumers want.

Founded in 1975, Microsoft (Nasdaq "MSFT") is the worldwide leader in software, services and Internet technologies for personal and business computing. The company offers a wide range of products and services designed to empower people through great software -- any time, any place and on any device. Microsoft and Windows are either registered trademarks or trademarks of Microsoft Corp. in the United States and/or other countries.

The names of actual companies and products mentioned herein may be the trademarks of their respective owners.

*Note to editors:* If you are interested in viewing additional information on Microsoft, please visit the Microsoft Web page at <http://www.microsoft.com/presspass/> on Microsoft's corporate information pages.





# NEWS

For Immediate Release  
December 11, 2001

Contact: Sean Rushton or Philippa Jeffery  
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## State AGs' Proposed Microsoft Case Remedies Are "Wishful Thinking"

*Only eight presents for Hanukkah, and there is no Santa Claus.*

Washington, D.C. - Citizens Against Government Waste (CAGW) today described the nine remaining state attorneys general in the Microsoft antitrust case as engaged in wishful thinking in their new proposed remedy package. The nine renegade states, California, Connecticut, District of Columbia, Florida, Iowa, Massachusetts, Minnesota, Utah, and West Virginia are continuing the litigation against the software company despite a settlement reached by nine other states and the U.S. Department of Justice.

"Who are these public officials kidding?" CAGW President Tom Schatz said. "While the holidays are here, there is no one — besides these AGs — generous enough to give such a gift to Microsoft's competitors. The proposal is pure fantasy, going far beyond the district court remedy, which was substantially narrowed by a higher court."

"Taxpayers will continue to foot the bill for the time and effort in this case, having already forked over more than \$35 million at the state and local level. The remaining nine states and the District of Columbia have an average of \$1.3 billion in budget deficits. California alone is in the red by \$9.5 billion, West Virginia is at \$3 million, and Minnesota has ordered 10 percent budget cuts. Citizens are justifiably angered in these troubled times by the continued misuse of their tax dollars on this litigation," Schatz said.

"The details of the proposed remedy read like a competitor's dream come true. The nearly two-dozen provisions are three times as generous as the eight nights of Hanukkah," Schatz said.

The states propose a 10-year remedy, twice as long as the one agreed to by the nine other states, DOJ, and Microsoft. During that time, every version of Windows would have to include Java, which is manufactured by Sun Microsystems. Microsoft's intellectual property would be available — essentially for free — to any competitor. A Special Master would have extraordinary powers to decide whether Microsoft is violating the agreement, and anyone can complain anonymously.

"Pursuit of this matter is particularly wasteful since the same judge that would approve the settlement between DOJ and Microsoft is presiding over the state litigation. If the AGs are really in the holiday spirit, they will stop misusing tax dollars on the Microsoft case and instead spend more time and effort protecting their citizens from terrorism," Schatz concluded.

CAGW is the nation's largest taxpayer advocacy group with over one million members and supporters nationwide. It is a nonpartisan, nonprofit organization dedicated to eliminating waste, fraud, mismanagement and abuse in government.

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## United States Senate

COMMITTEE ON THE JUDICIARY  
WASHINGTON, DC 20510-6275

November 29, 2001

The Honorable Charles A. James  
Assistant Attorney General  
Antitrust Division  
United States Department of Justice  
901 Pennsylvania Avenue, N.W.  
Washington, D.C. 20530

Re: United States v. Microsoft Corp., Civil Action No. 98-1232 (CKK)

Dear Assistant Attorney General James:

As you know, the Senate Judiciary Committee has a long-standing interest in the policy implications of the government's antitrust case in *United States v. Microsoft*. During my tenure as chairman, the Committee held a series of investigative hearings examining allegations of antitrust violations by Microsoft and the ability of existing law to address anti-competitive commercial conduct effectively and in a timely fashion. Many of the Committee's findings were later manifested in the decisions by the District Court and the Court of Appeals for the District of Columbia Circuit.

The resolution of this case has significance not only for the parties to the litigation, but also for the future application and enforcement of our nation's antitrust laws in the software industry. Given the Committee's continued interest in these policy questions, it would be extremely helpful for me and other members of the Committee to have a better understanding of the various legal, regulatory and practical considerations relating to the proposed settlement.

I have reviewed the Proposed Final Judgment ("PFJ") submitted by the Department of Justice and several of the state plaintiffs, as well as the Competitive Impact Statement ("CIS") filed by the Department on November 15, 2001. At the outset, I should note that the CIS provides information that further explains the implications of the proposed settlement and appears to satisfy your statutory obligation. Even so, I have a number of specific questions that I believe are critical to analyzing and understanding the PFJ. These questions are not intended to suggest a predisposition either in support of or in opposition to the settlement, and any

interpretation otherwise would signal a misunderstanding of my interest in this matter. Rather, the questions are intended to elicit important information that I believe is necessary for forming an independent, objective, and informed analysis of the PFJ. Such objective analysis is essential in view of the importance of this case to Microsoft and its competitors, to innovation in the high-technology industry, to the economy, and to consumers.

1. An earlier decision by the Court of Appeals, *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C.Cir. 1998) ("*Microsoft II*"), relating to the interpretation of an earlier consent decree with Microsoft, has been interpreted by some as expressing the view that judges should not be involved in software design, and that the government simply has no business telling Microsoft or any other company what it can include in any of its products. In its most recent decision, however, the Court of Appeals said that to the extent that the decision in *Microsoft II* completely disclaimed judicial capacity to evaluate high-tech product design, it cannot be said to conform to prevailing antitrust doctrine. *See United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) ("*Microsoft III*"). Is the law clear that the Department does have a responsibility to assess the competitive implications of software design, in bringing antitrust enforcement actions? And, if so, does the Department have the necessary technical expertise and resources to perform such an evaluation?
2. To foster competition in "middleware" the PFJ requires disclosure of APIs and similar information, but it then limits this provision only to those instances where disclosure would be for "the sole purpose of interoperating with a Windows Operating System Product." Except for the limitation, this provision is almost exactly like a comparable provision in Judge Jackson's interim consent decree. Why did the Department decide to add this limitation to the PFJ, and what effect will the inclusion of the limitation have on restoring competition? Please explain the competitive significance of web-based services, and whether the PFJ guarantees interoperability with the servers that operate those web-based services?
3. The Department has concluded that the PFJ is in the "public interest," as required by the Tunney Act. Are you aware of any other case where a Tunney Act "public interest" determination has occurred with respect to a settlement where the underlying liability on the merits already has been affirmed by the Court of Appeals? To what extent should the scope of the District Court's deference to the Antitrust Division under the Tunney Act be affected by a Court of Appeals' prior affirmance of Sherman Act liability?
4. The Court of Appeals remanded the remedy issue because, among other reasons, the District Court failed to demonstrate how divestiture relief was designed to "'unfetter [the] market from anticompetitive conduct,' . . . to 'terminate the illegal monopoly, deny to the

defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future.” *Microsoft III*, 253 F.3d at 103 (quoting *Ford Motor Co. v. United States*, 405 U.S. 562, 577 (1972), *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 250 (1968)). Please describe how the PFJ meets this standard dictated by the appellate court. (a) How does the PFJ “terminate the monopoly” Microsoft was found by the Appellate Court to have unlawfully maintained over PC operating system software? (b) How does the PFJ “deny to Microsoft the fruits of its Section 2 violation?” and (c) How does the PFJ “ensure that there remain no practices likely to result in monopolization in the future?”

5. Are there findings by the appellate court against Microsoft that are not addressed by the PFJ? If so, what were the reasons why the Department chose not to address these findings?
6. The Court of Appeals held that it was illegal for Microsoft to bind products together with Windows by “commingling code” because this practice helped Microsoft unlawfully maintain its desktop operating system monopoly. The Court concluded that code commingling has an “anticompetitive effect” by deterring OEMs from pre-installing rival software, “thereby reducing the rivals’ usage share and, hence, developers’ interest in rivals’ APIs as an alternative to the API set exposed by Microsoft’s operating system.” *Microsoft III*, 153 F.3d at 66. How does the PFJ prevent Microsoft from future unlawful commingling of non-Windows code with Windows?
7. You have said that Microsoft “won the right to sell integrated products,” and that “the tying claim was eliminated by the appeals court.” (Business Week, November 19, 2001, p. 116). Other observers, however, argue that the Court of Appeals simply vacated the per se findings of a tying law violation and remanded that issue for consideration under a “rule of reason” standard? Why did the Department conclude that the tying claim was “eliminated” and not simply remanded to be retried under a different standard? What are the circumstances, if any, under which the court or the Department could find it impermissible for Microsoft to “integrate” a product with its Windows operating system?
8. The CIS acknowledges that the “users rarely switched from whatever browsing software was placed most readily at their disposal.” It has been suggested that the most effective way to restore competition and to prevent future misconduct would be to require Microsoft to sell a product that is simply an operating system without all of the various applications that are now incorporated into Windows. Without such a requirement, the argument goes, consumers would be forced to procure two products if they choose to use a non-Microsoft version of a product that has been included in the operating system – Microsoft’s version and the competitor’s version. If Microsoft middleware is preinstalled

with Windows, how do you think the adoption rate by users of non-Microsoft middleware will be affected? Did the Department consider including in the PFJ a requirement that Microsoft sell a version of Windows that is solely an operating system without other applications bundled with it?

9. Some observers claim the Court of Appeals found that Microsoft's technological tying, particularly its "commingling of code," was an illegal act of monopolization under Section 2 of the Sherman Act, but that there was insufficient evidence to determine that the same conduct violated Section 1. Do you agree with this? Does the PFJ provide a remedy for such misconduct? In your analysis, does the failure to find that the conduct violated Section 1 obviate the need to provide a remedy for the violation the court found under Section 2?
10. Some Wall Street analysts have opined that the PFJ imposes no obligation on Microsoft to change its business practices or redesign its products. Instead, these analysts have concluded, the PFJ seeks to restore competition by permitting OEMs to add products to Microsoft's desktop. Is this view of the PFJ accurate? Is it the Department's position that OEMs are in the best economic position to restore competition in personal computing? If so, what is the basis for that position? Are there other entities that might be in a position to help restore competition?
11. A significant portion of the *Microsoft III* opinion was devoted to Microsoft's conduct vis-a-vis Java technology. The Court found Microsoft unlawfully used distribution agreements to forestall competition with middleware manufacturers. *See, e.g., Microsoft III*, 253 F.3d at 74-78. The court found these agreements to be anticompetitive because they "foreclosed a substantial portion of the field for . . . distribution and because, in so doing, they protected Microsoft's monopoly from a middleware threat." *Id. at 76*. Does the PFJ addresses such practices?
12. The Supreme Court has said that in an antitrust remedy, "it is not necessary that all of the untraveled roads to that [unlawful] end be left open and that only the worn one be closed." *International Salt Co. v. United States*, 332 U.S. 392, 401 (1947). The Court also has made clear that injunctive relief which simply "forbid[s] a repetition of the illegal conduct" is not sufficient under Section 2, because defendants "could retain the full dividends of their monopolistic practices and profit from the unlawful restraints of trade which they had inflicted on competitors." *Schine Chain Theatres, Inc. v. United States*, 334 U.S. 110, 128 (1948). Are the standards enunciated by the Court in *International Salt* and *Schine Chain Theatres* applicable in the Microsoft case? If so, would you identify provisions in the PFJ that satisfy these standards?

13. The Supreme Court also has held that a Section 2 monopolization remedy "must break up or render impotent the monopoly power found to be in violation of the Act." *United States v. Grinnell Corp.*, 384 U.S. 563, 577 (1966). Does the PFJ "render impotent" Microsoft's Windows monopoly and, if so, how?
14. There has been considerable discussion about Microsoft's Windows XP product, with some critics arguing that Microsoft is repeating the same technical binding, bundling and monopoly maintenance tactics found by the court to be unlawful when used in the past against Microsoft's competitors. If true, this allegation would be significant, given the appellate court's instruction "that there remain no practices likely to result in monopolization in the future," *Microsoft III*, 253 F.3d at 103 (quoting *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 250 (1968)). Some critics have also charged that Microsoft's broad .NET strategy is an effort to build upon the fruits of Microsoft's past unlawful conduct and remake the Internet as a Microsoft-proprietary Internet. Does the PFJ apply to Windows XP or to Microsoft's .NET strategy? If not, why has the Department decided not to apply the settlement to these products? Can competition in the operating system be restored without addressing these products?
15. Many of the provisions of the PFJ appear to assume that OEMs will act to aggregate operating system software and assume the role of desktop design and software packaging in the PC distribution chain. According to many observers, however, there simply is no financial incentive for OEMs to do anything but accept the full Microsoft software package. What is the Department's position on this issue? Was any consideration given to reports that OEMs did not take advantage of an offer by Microsoft this past summer to replace icons in the Windows XP desktop?
16. The Court of Appeals affirmed that Microsoft's conduct with respect to Java, in which the Court found it to engage in a "campaign to deceive [Java] developers" and "polluted" the Java standard in order to defeat competition to its operating system monopoly violated Section 2 of the Sherman Act. The Court held "Microsoft's conduct related to its Java developer tools served to protect its monopoly of the operating system in a manner not attributable either to the superiority of the operating system or to the acumen of its makers, and therefore was anticompetitive. Unsurprisingly, Microsoft offers no procompetitive explanation for its campaign to deceive developers. Accordingly, we conclude this conduct is exclusionary, in violation of Section 2 of the Sherman Act." *Microsoft III*, slip op. p. 101. As you know, the lower court decree included a provision designed to prevent deliberate sabotaging of competing products by Microsoft. Does the PFJ restrict Microsoft's ability to modify, alter, or refuse to support computer industry standards, including Java, or to engage in campaigns to deceive developers of competitor platform, middleware or applications software?

17. The Court of Appeals found that Microsoft violated Section 2 of the Sherman Act by entering into an exclusive contract with Apple that required Apple to install Internet Explorer as the Macintosh browser. *Microsoft III*, 252 F3d at 72-74. Many observers accuse Microsoft of having forced Apple to enter into the contract by threatening to withhold the porting of Microsoft Office to the Macintosh operating system. Does the PFJ prohibit Microsoft from threatening to withhold development of Microsoft Office with respect to other platforms, such as handheld devices, set-top boxes, and phones? If no, why did the Department choose not to address this concern in the PFJ?
18. You have been quoted as saying that various software and computer services companies are in the process of purchasing space on the desktop from Microsoft. (Business Week, November 19, 2001, p. 116). In the Department's view, is the space on the desktop on computers manufactured by the OEMs owned by Microsoft or should that space be the property of the computer manufacturers?
19. The CIS suggests the Department has embraced the goal of encouraging competitive development of "middleware" in order that such middleware can become the type of platform software that could challenge the operating system monopoly. The settlement requires Microsoft to allow OEMs to remove consumer "access" to the company's "middleware." It has been observed, however, that since the code for Microsoft's "middleware" is commingled with Windows, OEMs are only allowed to remove the icon for a middleware application. The CIS seems to acknowledge that Microsoft understood that software developers would only write to the APIs exposed by Navigator in numbers large enough to threaten the applications barrier to entry if they believe that Navigator would emerge as the standard software employed to browse the web. Can you explain why you believe third-party application developers would write applications to non-Microsoft APIs if the Microsoft middleware APIs as well as the Windows APIs will be present on over 95% of the personal computers sold?
20. Concerns have been raised about the consequences of several "provisos" that have been included in the PFJ. For example, Section III.H.3 prohibits Microsoft from denying consumers the choice of using competing applications, but a proviso to this language states that Microsoft can challenge a consumer's decision to choose an application other than its own after 14 days and encourage the consumer to switch back to the Microsoft product. What does the Department believe will be the impact of the messages that Microsoft will be able to send to consumers on their own computers? Are other companies permitted to send comparable messages to consumers who choose to utilize Microsoft products? Finally, why did the Department choose a period of 14 days as opposed to some other period of time?

21. Under Sections III.H and VI.N a competing middleware application receives protection under the PFJ, but this protection applies only if the competitor ships at least one million units over the course of a year. Why did the Department choose that particular number? Did the Department give consideration to the argument that small innovators, who may be in the initial stages of product development and sales, might be in need of greater protection than a company capable of selling more than one million units?
23. Section III.B of the PFJ prohibits Microsoft from engaging in discriminatory pricing of its desktop operating system with OEMs. Does the PFJ also prohibit use of this same kind of discriminatory pricing against server operating systems and other non-Windows software?
24. The interim decree proposed by Judge Jackson included a provision precluding Microsoft from taking knowing action to disable or adversely affect the operation of competing middleware software. Does the PFJ contain a comparable provision? If not, what was the Department's rationale for not including this prohibition in the proposed settlement?
25. Why did the Department choose not to present evidence to the District Court on current PC operating system market developments, including changes in the Internet browser market share since the trial began? Did the Department undertake an investigation of current market developments to determine the impact of the PFJ on the existing market realities? For example, was there an analysis of the impact of the proposed settlement on Microsoft's proposed future products and services?
26. The CIS suggests that the District Court's role under the Antitrust Procedures and Penalties Act is limited to reviewing the remedy in relationship to the violations that the United States has alleged in its complaint. *See* CIS at p. 67. Yet the authorities cited for that proposition appear to be cases that were settled before trial. Some observers argue that in this case the District Court should review the settlement in relationship to the Court of Appeals ruling rather than to the violations alleged in the original complaint. Does the Department agree with that assessment?
27. Has the Department undertaken any studies to determine the effectiveness of its prior consent decree with Microsoft in restoring competition? How do you believe prior obstacles to enforcement of consent decrees with Microsoft are addressed in the PFJ?
28. Do you believe that current antitrust law is sufficient to guarantee not only competition but timely enforcement in areas such as the software industry?



The Honorable Charles A. James  
November 29, 2001  
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29. What steps, if any, should be taken, legislatively or otherwise, to ensure that the Department has the proper economic and technological resources to enforce the law in the software industry?

I appreciate your cooperation with this request. As I hope you agree, a better understanding of the Department's objectives and the scope of the remedy measures included in — as well as excluded from — the PFJ will serve the long-term interest we share in proper application of the antitrust laws to the emerging information economy.

I look forward to your response and to the opportunity to address these issues with you, Microsoft and other interested parties in the coming weeks.

Sincerely,

A handwritten signature in black ink, appearing to read "Orrin Hatch", written over a circular stamp or seal.

Orrin G. Hatch  
Ranking Republican Member



U.S. Department of Justice  
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

December 11, 2001

Honorable Orrin Hatch  
United State Senate  
Washington, D.C. 20510

Dear Senator Hatch:

This is in response to your letter of November 29, requesting responses to questions regarding *U.S. v. Microsoft*.

As you know, the Department has stipulated to entry of a proposed Final Judgment resolving all remaining claims in the case, and that settlement is undergoing Tunney Act review before the District Court. The Department believes the proposed Final Judgment is in the public interest and will be entered by the Court at the conclusion of the Tunney Act process.

Nevertheless, the Department must be mindful of the Court's prerogatives and the possibility, however remote, of future litigation regarding the merits of the case or the settlement itself. Accordingly, given the pendency of the case, the Department is constrained in the amount of detail it can offer in these responses. It would be inappropriate, for example, for the Department to specify legal positions it must take with regard to potentially contested issues or to speculate about future enforcement positions the Department might take with regard to current or future conduct by specific firms. As a Senator who has been a strong supporter of effective antitrust enforcement, I am sure that you appreciate the reasons for such constraint.

At the outset, and prior to responding to your specific questions, please allow me to offer two general perspectives that provide context for the Department's responses.

First, *U.S. v. Microsoft* is and always has been a law enforcement initiative. It involves specific allegations investigated by the Department and litigated in the courts. The boundaries of the case are determined by the allegations of the Department's complaint and the manner in which those allegations have been resolved by the courts--in particular, the Court of Appeals. Within the context of this specific case, the Department has no legal mandate to act outside of these boundaries.

Second, there is a wide gulf between permissible relief under the antitrust laws and the manner in which Microsoft's competitors would prefer to see Microsoft constrained in future competition. As I know you appreciate, our goal as antitrust enforcers is to ensure that Microsoft competes fairly within the confines of the antitrust laws for the benefit of consumers, not to obtain specific competitive advantages for the benefit of Microsoft's competitors.

With these perspectives in mind, and subject to the foregoing caveats, the Department is pleased to provide the following responses.

## QUESTION

1. An earlier decision by the Court of Appeals, *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C. Cir. 1998) ("*Microsoft II*"), relating to the interpretation of an earlier consent decree with Microsoft, has been interpreted by some as expressing the view that judges should not be involved in software design, and that the government simply has no business telling Microsoft or any other company what it can include in any of its products. In its most recent decision, however, the Court of Appeals said that to the extent that the decision in *Microsoft II* completely disclaimed judicial capacity to evaluate high-tech product design, it cannot be said to conform to prevailing antitrust doctrine. See *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) ("*Microsoft III*"). Is the law clear that the Department does have a responsibility to assess the competitive implications of software design, in bringing antitrust enforcement actions? And, if so, does the Department have the necessary technical expertise and resources to perform such an evaluation?

## ANSWER

In exercising its responsibility to enforce the antitrust laws, the Department routinely confronts complex issues, including economic and technical issues regarding software design. The Department has both the resources and capability to address such issues, as they affect enforcement matters, through internal means and, where appropriate, the retention of outside experts.

## QUESTION

2. To foster competition in "middleware" the PFJ requires disclosure of APIs and similar information, but it then limits this provision only to those instances where disclosure would be for "the sole purpose of interoperating with a Windows Operating System Product." Except for the limitation, this provision is almost exactly like a comparable provision in Judge Jackson's interim consent decree. Why did the Department decide to add this limitation to the PFJ, and what effect will the inclusion of the limitation have on restoring competition? Please explain the competitive significance of web-based services, and whether the PFJ guarantees interoperability with the servers that operate those web-based services?

## ANSWER

The insertion of "for the sole purpose of interoperating with a Windows Operating System Product" in Section III.D. of the proposed Final Judgment simply clarifies that the APIs must be used for the purpose intended under the settlement (and as intended in Judge Jackson's order)—ensuring that developers of competing middleware products will have full access to the same information that Microsoft middleware uses to interoperate with the Windows operating system. That is, the disclosure is not intended to permit misappropriation of Microsoft's intellectual property for other uses. The insertion of this clause will not change the provision's ability to restore competition in any way.

The concept of "web-based" services is constantly evolving as companies find new ways to use the Internet. The ultimate competitive significance of such services remains to be determined. The Department's case addressed the topic of web-based services only with respect to the middleware threat to the operating system. Section III.E. of the proposed Final Judgment ensures that software developers will have full access to, and be able to use, the communication protocols necessary for server operating system software located on a server computer to interoperate with the functionality embedded in the Windows operating system.

## QUESTION

3. The Department has concluded that the PFJ is in the "public interest," as required by the Tunney Act. Are you aware of any other case where a Tunney Act "public interest" determination has occurred with respect to a settlement where the underlying liability on the merits already has been affirmed by the Court of Appeals? To what extent should the scope of the District Court's deference to the Antitrust Division under the Tunney Act be affected by a Court of Appeals' prior affirmance of Sherman Act liability?

## ANSWER

The Department is not aware of a case where a court has made a Tunney Act "public interest" determination with respect to a settlement where the underlying liability on the merits already had been affirmed by the Court of Appeals. Beyond the Department's position set forth in its submissions to the Court, it would be inappropriate for the Department to comment on the appropriate scope of the Court's discretion because the Court's review of the proposed Final Judgment is pending under the Tunney Act.

## QUESTION

4. The Court of Appeals remanded the remedy issue because, among other reasons, the District Court failed to demonstrate how divestiture relief was designed to "'unfetter [the] market from anticompetitive conduct,' ... to 'terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future'" *Microsoft III*, 253 F.3d at 103 (quoting *Ford Motor Co. V. United States*, 405

U.S. 562, 577 (1972), *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 250 (1968)). Please describe how the PFJ meets this standard dictated by the appellate court. (a) How does the PFJ "terminate the monopoly" Microsoft was found by the Appellate Court to have unlawfully maintained over PC operating system software? (b) How does the PFJ "deny to Microsoft the fruits of its Section 2 violation?" and (c) How does the PFJ "ensure that there remain no practices likely to result in monopolization in the future?"

## ANSWER

In the two cases quoted above, the monopoly in question was obtained by unlawful means. It was never alleged in this case, however, that Microsoft unlawfully *obtained* its operating system monopoly. Further, as the Court of Appeals noted, "the District Court expressly did not adopt the position that Microsoft would have lost its position in the OS market but for its anticompetitive behavior." *U.S. v. Microsoft*, 253 F.3d 34, 107 (D.C. Cir. 2001). The Court of Appeals also went on to hold that: "[s]tructural relief, which is 'designed to eliminate the monopoly altogether . . . require[s] a clear indication of a significant causal connection between the conduct and creation or maintenance of the market power.' Absent such causation, the antitrust defendant's unlawful behavior should be remedied by 'an injunction against continuation of that conduct.'" *Id.* at 106 (quoting 3 AREEDA & HOVENKAMP, ANTITRUST LAW ¶653b, at 91-92, and ¶650a, at 67). The injunctive relief in this case, with no allegation Microsoft unlawfully obtained its operating system monopoly, is designed to stop the unlawful conduct, prevent its recurrence and restore lost competition in the market. See *Microsoft*, 253 F.3d at 103 (quoting *Ford Motor Co. v. United States*, 405 U.S. 562, 577 (1972) and *United States v. United Shoe Mach. Corp.*, 391 U.S. 244, 250 (1968)).

The proposed Final Judgment stops the offending conduct by enjoining the unlawful actions that the District Court and the Court of Appeals sustained. The proposed Final Judgment enjoins exclusive and unlawful dealing, gives computer manufacturers and consumers extensive control of the desktop and initial boot sequence, ensures that developers can develop products that interoperate with the Windows operating system, and prohibits a broad range of retaliatory conduct. The proposed Final Judgment prevents the recurrence of the conduct identified as unlawful by addressing the broad range of potential strategies Microsoft might deploy to impede the emergence of competing middleware products. The proposed Final Judgment also seeks to restore lost competition posed by the potential middleware threat to Microsoft's operating system monopoly by requiring Microsoft to, among other things: (i) disclose APIs that will give independent software developers the opportunity to match Microsoft's middleware functionality; (ii) allow computer manufacturers and users to replace Microsoft middleware with independently developed middleware; and (iii) create and preserve "default" settings that will ensure that Microsoft's middleware does not over-ride the selection of third-party middleware products.

## QUESTION

5. Are there findings by the appellate court against Microsoft that are not addressed by the PFJ? If

so, what were the reasons why the Department chose not to address these findings?

#### ANSWER

The proposed Final Judgment addresses each of the Court of Appeals' findings, and even goes beyond them.

#### QUESTION

6. The Court of Appeals held that it was illegal for Microsoft to bind products together with Windows by "commingling code" because this practice helped Microsoft unlawfully maintain its desktop operating system monopoly. The Court concluded that code commingling has an "anticompetitive effect" by deterring OEMs from pre-installing rival software, "thereby reducing the rivals' usage share and, hence, developers' interest in rivals' APIs as an alternative to the API set exposed by Microsoft's operating system." *Microsoft III*, 153 F.3d at 66. How does the PFJ prevent Microsoft from future unlawful commingling of non-Windows code with Windows?

#### ANSWER

The proposed Final Judgment addresses these issues by requiring Microsoft to redesign its operating system to include an effective add/remove function for all Microsoft middleware products and to permit competing middleware to take on a default status that will override middleware functions Microsoft has integrated into the operating system. The proposed Final Judgment does not contain an absolute prohibition on Microsoft commingling code within Windows, and the Department does not interpret the Court of Appeals decision as requiring such relief.

#### QUESTION

7. You have said that Microsoft "won the right to sell integrated products," and that "the tying claim was eliminated by the appeals court." (Business Week, November 19, 2001, p. 116). Other observers, however, argue that the Court of Appeals simply vacated the per se findings of a tying law violation and remanded that issue for consideration under a "rule of reason" standard? Why did the Department conclude that the tying claim was "eliminated" and not simply remanded to be retried under a different standard? What are the circumstances, if any, under which the court or the Department could find it impermissible for Microsoft to "integrate" a product with its Windows operating system?

#### ANSWER

The Court of Appeals reversed the per se tying claim and remanded it to the lower court for adjudication under a more rigorous legal standard. The Court also held that if the Department pursued the tying claim on remand it would be precluded from arguing any theory of harm relying on a precise definition of browsers or barriers to entry, even though the government would have

the burden of showing an anticompetitive effect in the browser market. The Court of Appeals also invited an extensive and complex analysis of pricing, noting that other operating system manufacturers included Web browsers in their operating systems, and requiring the plaintiffs to show that any anticompetitive effects outweighed the procompetitive effects. In light of the Court's decision and the desire to achieve prompt relief for consumers without protracted litigation and appeals, the Department and the state plaintiffs decided not to pursue the tying claim.

Given the continuing pendency of this litigation and the possibility that these issues may arise in other contexts, it is not appropriate for the Department to speculate under what circumstances Microsoft's conduct would be impermissible.

## QUESTION

8. The CIS acknowledges that the "users rarely switched from whatever browsing software was placed most readily at their disposal." It has been suggested that the most effective way to restore competition and to prevent future misconduct would be to require Microsoft to sell a product that is simply an operating system without all of the various applications that are now incorporated into Windows. Without such a requirement, the argument goes, consumers would be forced to procure two products if they choose to use a non-Microsoft version of a product that has been included in the operating system -- Microsoft's version and the competitor's version. If Microsoft middleware is preinstalled with Windows, how do you think the adoption rate by users of non-Microsoft middleware will be affected? Did the Department consider including in the PFJ a requirement that Microsoft sell a version of Windows that is solely an operating system without other applications bundled with it?

## ANSWER

The Department did consider, and ultimately, reject a remedy that would have required Microsoft to sell a version of its operating system that did not contain some or all of the applications that it typically includes with the Windows operating system. First, this relief would have been most appropriate to remedy the tying and attempted monopolization liability (which were not sustained by the Court of Appeals), rather than for monopoly maintenance. Second, the remedy would reduce consumer choice rather than increase it. The proposed Final Judgment provides computer manufacturers the option of featuring, and end users the option of selecting, alternative middleware products, which they may choose to use or replace. Even if Microsoft middleware is preinstalled on the computer, computer manufacturers will have the ability to remove access to it and replace it with independently developed middleware. In this way, competition for consumer patronage of middleware products, unfettered by artificial restrictions by Microsoft, will determine adoption rates.

## QUESTION

9. Some observers claim the Court of Appeals found that Microsoft's technological tying, particularly

its "commingling of code," was an illegal act of monopolization under Section 2 of the Sherman Act, but that there was insufficient evidence to determine that the same conduct violated Section 1. Do you agree with this? Does the PFJ provide a remedy for such misconduct? In your analysis, does the failure to find that the conduct violated Section 1 obviate the need to provide a remedy for the violation the court found under Section 2?

#### ANSWER

The Court of Appeals observed some overlap between the tying claim and the code integration issues under the monopoly maintenance claim. However, as the Court of Appeals noted, the District Court concluded that tying and commingling are two different things — "[a]lthough the District Court also found that Microsoft commingled the operating system-only and browser-only routines in the same library files, it did not include this as a basis for tying liability despite plaintiffs' request that it do so." *U.S. v. Microsoft*, 253 F.3d 34, 85 (D.C. Cir. 2001). The Department believes that the proposed Final Judgment effectively addresses the integration issues of the monopoly maintenance claim by requiring Microsoft to redesign its operating system to include an effective add/remove function for all Microsoft middleware products and to permit competing middleware to be featured in its place, as well as take on a default status that will, if the consumer chooses, override middleware functions Microsoft has integrated into the operating system.

#### QUESTION

10. Some Wall Street analysts have opined that the PFJ imposes no obligation on Microsoft to change its business practices or redesign its products. Instead, these analysts have concluded, the PFJ seeks to restore competition by permitting OEMs to add products to Microsoft's desktop. Is this view of the PFJ accurate? Is it the Department's position that OEMs are in the best economic position to restore competition in personal computing? If so, what is the basis for that position? Are there other entities that might be in a position to help restore competition?

#### ANSWER

The Department fundamentally disagrees with this characterization of the proposed Final Judgment. The proposed Final Judgment will require Microsoft to fundamentally change the way in which it deals with computer manufacturers, Internet access providers, software developers and others within the computer industry with regard to the manner in which it designs, sells, and shares information regarding its operating system. The proposed Final Judgment does not reflect a position by the Department that computer manufacturers are the only distribution outlet for software or that they are the only ones in a position to help restore competition. In fact, consumers increasingly obtain software in various distribution channels apart from computer manufacturers. Rather, certain provisions in the proposed Final Judgment focus on computer manufacturers because the restrictions on computer manufacturers to distribute software was a primary focus of the case and the Court of Appeals concluded that computer manufacturers were a critical distribution channel for Windows, as well as for middleware and other software applications.



## QUESTION

11. A significant portion of the *Microsoft III* opinion was devoted to Microsoft's conduct vis-a-vis Java technology. The Court found Microsoft unlawfully used distribution agreements to forestall competition with middleware manufacturers. *See, e.g., Microsoft III*, 253 F.3d at 74-78. The court found these agreements to be anticompetitive because they "foreclosed a substantial portion of the field for . . . distribution and because, in so doing, they protected Microsoft's monopoly from a middleware threat" *Id. at 76*. Does the PFJ address such practices?

## ANSWER

The proposed Final Judgment addresses such conduct by prohibiting Microsoft from entering into agreements that require software developers and other industry participants to exclusively distribute, promote, use or support a Microsoft middleware or operating system product, and by prohibiting Microsoft from retaliating against software developers who support competing middleware products.

## QUESTION

12. The Supreme Court has said that in an antitrust remedy, "it is not necessary that all of the untraveled roads to that [unlawful] end be left open and that only the worn one be closed." *International Salt Co. v. United States*, 332 U.S. 392, 401 (1947). The Court also has made clear that injunctive relief which simply "forbid[s] a repetition of the illegal conduct is not sufficient under Section 2, because defendants "could retain the full dividends of their monopolistic practices and profit from the unlawful restraints of trade which they had inflicted on competitors." *Schine Chain Theatres, Inc. v. United States*, 334 U.S. 110, 128 (1948). Are the standards enunciated by the Court in *International Salt* and *Schine Chain Theatres* applicable in the Microsoft case? If so, would you identify provisions in the PFJ that satisfy these standards?

## ANSWER

The obligations imposed on Microsoft in the proposed Final Judgment go considerably beyond merely stopping, and preventing the recurrence of, the specific acts found unlawful by the Court of Appeals. Specifically, the proposed Final Judgment goes further by: (i) applying a broad definition of middleware products, which goes well beyond the Web browser and Java technologies that were the focus of the Department's case, to include all of the technologies that have the potential to be middleware threats to Microsoft's operating system monopoly, including e-mail clients, media players, instant messaging software and future middleware developments; (ii) requiring the disclosure or licensing of middleware interfaces and server communications protocols not previously disclosed to ensure that non-Microsoft middleware and server software can interoperate with Microsoft's operating system; (iii) ensuring that computer manufacturers and

consumers have extensive control of the desktop and initial boot sequence; (iv) broadly banning certain exclusive dealing, retaliation and discrimination by Microsoft beyond the practices affirmed as anticompetitive by the Court of Appeals; (v) requiring Microsoft to license its operating system to key computer manufacturers on uniform terms; (vi) requiring Microsoft to license intellectual property to computer manufacturers and software developers necessary for them to exercise their rights under the proposed settlement; and (vii) implementing a panel of three independent, on-site, full-time experts to assist in enforcing the proposed Final Judgment.

## QUESTION

13. The Supreme Court also has held that a Section 2 monopolization remedy "must break up or render impotent the monopoly power found to be in violation of the Act." *United States v. Grinnell Corp.*, 384 U.S. 563, 577 (1966). Does the PFJ "render impotent" Microsoft's Windows monopoly and, if so, how?

## ANSWER

In the case against Microsoft there has never been any contention that Microsoft *obtained* its operating system monopoly through unlawful means. Instead, the allegation sustained by the Court of Appeals was that Microsoft engaged in specific unlawful acts, not a course of conduct, to *maintain* its monopoly in violation of Section 2. Because relief in a Section 2 case must have its foundation in the offending conduct, the Department's view was that the monopoly maintenance finding, as modified by the Court of Appeals, and without the "course-of-conduct" theory, did not sustain a broad-ranging remedy, such as a "break up" of Microsoft's operating system monopoly, that went beyond what was necessary to address Microsoft's unlawful responses to the middleware threat. Thus, the proposed Final Judgment does not seek such break-up relief.

## QUESTION

14. There has been considerable discussion about Microsoft's Windows XP product, with some critics arguing that Microsoft is repeating the same technical binding, bundling and monopoly maintenance tactics found by the court to be unlawful when used in the past against Microsoft's competitors. If true, this allegation would be significant, given the appellate court's instruction "that there remain no practices likely to result in monopolization in the future," *Microsoft III*, 253 F.3d at 103 (quoting *United States v. United Shore Mach. Corp.*, 391 U.S. 244, 250 (1968)). Some critics have also charged that Microsoft's broad .NET strategy is an effort to build upon the fruits of Microsoft's past unlawful conduct and remake the Internet as a Microsoft-proprietary Internet. Does the PFJ apply to Windows XP or to Microsoft's .NET strategy? If not, why has the Department decided not to apply the settlement to these products? Can competition in the operating system be restored without addressing these products?

## ANSWER

With the monopoly maintenance claim as the only surviving basis for relief, the proposed Final Judgment must focus on middleware or middleware-type threats to the operating system, not Microsoft's participation in other markets in a way unrelated to the conduct by Microsoft found unlawful by the Court of Appeals. The proposed Final Judgment expressly applies to Windows XP and any successors during the term of the judgment (*see* definition of Windows Operating System Product). It also applies to a wide variety of current and future Microsoft middleware products. What has been labeled .NET is a relatively new, diverse initiative by Microsoft in the market. As parts of .NET come more fully to fruition, they will be evaluated under the proposed Final Judgment, as would any other software. For instance, parts of the .NET strategy are likely to be middleware, such as instant messaging clients. To the extent .NET software or conduct implicates the anticompetitive acts raised in the case, it would be addressed under the proposed Final Judgment or otherwise by the Department.

## QUESTION

15. Many of the provisions of the PFJ appear to assume that OEMs will act to aggregate operating system software and assume the role of desktop design and software packaging in the PC distribution chain. According to many observers, however, there simply is no financial incentive for OEMs to do anything but accept the full Microsoft software package. What is the Department's position on this issue? Was any consideration given to reports that OEMs did not take advantage of an offer by Microsoft this past summer to replace icons in the Windows XP desktop?

## ANSWER

During the trial, the Department showed, and the Court of Appeals found, that computer manufacturers are a key distribution channel for Windows, as well as for middleware and other software applications. Further, even before the proposed Final Judgment was executed, computer manufacturers were entering into agreements with non-Microsoft middleware suppliers to place their products on the Windows operating system. With the implementation of the proposed Final Judgment, which provides computer manufacturers with greater freedom with respect to replacing Microsoft middleware products, computer manufacturers should have even greater incentives to do so. The powers extend well beyond the limited rights Microsoft afforded when Windows XP was introduced this past summer. The true test will occur as the uncertainty surrounding the case is removed by the proposed Final Judgment, when the proposed Final Judgment's anti-retaliation and anti-discrimination terms are in place, and when new middleware products emerge on the market.

## QUESTION

16. The Court of Appeals affirmed that Microsoft's conduct with respect to Java, in which the Court found it to engage in a "campaign to deceive [Java] developers" and "polluted" the Java standard in order to defeat competition to its operating system monopoly violated Section 2 of the Sherman Act. The Court held "Microsoft's conduct related to its Java developer tools served to protect its monopoly of the operating system in a manner not attributable either to the superiority of the operating system or to the acumen of its makers, and therefore was anticompetitive. Unsurprisingly, Microsoft offers no procompetitive explanation for its campaign to deceive developers. Accordingly, we conclude this conduct is exclusionary, in violation of Section 2 of the Sherman Act." *Microsoft III*, Slip Op. p. 101. As you know, the lower court decree included a provision designed to prevent deliberate sabotaging of competing products by Microsoft. Does the PFJ restrict Microsoft's ability to modify, alter, or refuse to support computer industry standards, including Java, or to engage in campaigns to deceive developers of competitor platform, middleware or applications software?

## ANSWER

The proposed Final Judgment does not expressly restrict Microsoft's ability to modify, alter, or refuse to support computer industry standards, or engage in campaigns to deceive software developers. The Department chose not to include the referenced provision because the term originally included in Judge Jackson's order allowed Microsoft to take steps to change its operating system that would interfere with third-party's middleware to interoperate *as long as* Microsoft informed the third party of the change and what, if anything, could be done to fix the problem. This would have, in effect, given Microsoft a license to interfere with competing middleware as long as it simply notified the competing developer. In addition, this provision would have been difficult for the Department to enforce in this case because of the constant changes Microsoft makes to its operating system, which while potentially procompetitive, may have the unintentional consequence of affecting a competing product's interoperability. Therefore, implementing this provision would have resulted in unnecessary compliance disputes.

The proposed Final Judgment hinders Microsoft's ability to disadvantage competing middleware developers by making the means by which middleware products interoperate with the operating system more transparent. The proposed Final Judgment requires Microsoft to now disclose those APIs that its middleware products use to interoperate with the operating system. Disclosure of these APIs will make it harder for Microsoft to interfere with competing middleware. Further, to the extent computer industry standards are implemented in communications protocols, as often occurs, Microsoft must license those protocols in accordance with Section III.E., including any modifications or alterations to the industry standard protocols. When the industry standard is implemented between a Microsoft middleware product, such as its Java Virtual Machine, and the operating system, Microsoft must disclose that interface.

## QUESTION

17. The Court of Appeals found that Microsoft violated Section 2 of the Sherman Act by entering into an exclusive contract with Apple that required Apple to install Internet Explorer as the Macintosh browser. *Microsoft III*, 252 F.3d at 72-74. Many observers accuse Microsoft of having forced Apple to enter into the contract by threatening to withhold the porting of Microsoft Office to the Macintosh operating system. Does the PFJ prohibit Microsoft from threatening to withhold development of Microsoft Office with respect to other platforms, such as handheld devices, set-top boxes, and phones? If no, why did the Department choose not to address this concern in the PFJ?

## ANSWER

The proposed Final Judgment would prohibit Microsoft from threatening to withhold the development of Microsoft Office for other platforms, such as handheld devices, set-top boxes and phones, if it did so because the software or hardware developer was developing, using, distributing, promoting or supporting any software that competes with Microsoft's middleware or operating system products (or any software that runs on any software that competes with Microsoft's middleware or operating system products), or because the developer exercises any of the options or alternatives provided for under the proposed Final Judgment.

## QUESTION

18. You have been quoted as saying that various software and computer services companies are in the process of purchasing space on the desktop from Microsoft. (Business Week, November 19, 2001, p. 116). In the Department's view, is the space on the desktop on computers manufactured by the OEMs owned by Microsoft or should that space be the property of the computer manufacturers?

## ANSWER

Whether the space on the desktop is owned by Microsoft or is the property of the computer manufacturers does not impact the effectiveness of the proposed Final Judgment in remedying the anticompetitive conduct by Microsoft. The Department does not have a view as to whether the space on the desktop should be viewed as the property of Microsoft or the computer manufacturers. The Department does have the view that Microsoft middleware and competing middleware should compete for the space, and the proposed Final Judgment ensures that this competition occurs.

## QUESTION

19. The CIS suggests the Department has embraced the goal of encouraging competitive development of "middleware" in order that such middleware can become the type of platform software that could challenge the operating system monopoly. The settlement requires Microsoft to allow OEMs

to remove consumer "access" to the company's "middleware." It has been observed, however, that since the code for Microsoft's "middleware" is commingled with Windows, OEMs are only allowed to remove the icon for a middleware application. The CIS seems to acknowledge that Microsoft understood that software developers would only write to the APIs exposed by Navigator in numbers large enough to threaten the applications barrier to entry if they believe that Navigator would emerge as the standard software employed to browse the web. Can you explain why you believe third-party application developers would write applications to non-Microsoft APIs if the Microsoft middleware APIs as well as the Windows APIs will be present on over 95% of the personal computers sold?

## ANSWER

The proposed Final Judgment will require Microsoft to do more than simply allow for the removal of its middleware icons. It requires that Microsoft allow end users and computer manufacturers to remove other means of access to, and override automatic invocations of, Microsoft middleware products and replace them with independently developed middleware products. Therefore, regardless of whether some portion of the Microsoft middleware code remains, end users and computer manufacturers can remove access to such middleware and replace it with alternative middleware. As the trial demonstrated, actual usage of a middleware product by the consumer, and not simply the presence of the product's code on the computer, has competitive significance. The marketplace, however, will determine whether any particular middleware product becomes sufficiently ubiquitous. This will ensure that competing middleware products will have the opportunity to compete for placement on the personal computer and that consumers will have a choice.

## QUESTION

20. Concerns have been raised about the consequences of several "provisos" that have been included in the PFJ. For example, Section III.H.3 prohibits Microsoft from denying consumers the choice of using competing applications, but a proviso to this language states that Microsoft can challenge a consumer's decision to choose an application other than its own after 14 days and encourage the consumer to switch back to the Microsoft product. What does the Department believe will be the impact of the messages that Microsoft will be able to send to consumers on their own computers? Are other companies permitted to send comparable messages to consumers who choose to utilize Microsoft products? Finally, why did the Department choose a period of 14 days as opposed to some other period of time?

## ANSWER

It is incorrect that the proposed Final Judgment allows Microsoft to "challenge" a consumer's decision to select a non-Microsoft middleware product. Some end users prefer to have icons readily available on the desktop; others prefer a "clean desktop." In Windows XP, Microsoft has a Clean Desktop Wizard, which asks a user whether he or she would like to have unused icons

(whether for Microsoft products or other products) taken off the desktop and placed in a folder, where they can still be easily accessed. The proposed Final Judgment allows Microsoft to continue providing this cleanup function, which the user can choose to take advantage of or not. The impact will be that end users can exercise choice. The proposed Final Judgment requires Microsoft to wait 14 days before it seeks confirmation from the end user because this will ensure that end users have a meaningful opportunity to determine which products, if any, they want to keep on the desktop.

## QUESTION

21. Under Sections III.H and VI.N, a competing middleware application receives protection under the PFJ, but this protection applies only if the competitor ships at least one million units over the course of a year. Why did the Department choose that particular number? Did the Department give consideration to the argument that small innovators, who may be in the initial stages of product development and sales, might be in need of greater protection than a company capable of selling more than one million units?

## ANSWER

The one million copies figure is implicated only in the operative provision contained in Section III.H. of the proposed Final Judgment and only to a very limited extent in Section III.D. Section III.H. requires Microsoft to include in Windows an effective add/remove function to allow end users and computer manufacturers to enable or remove access to Microsoft and non-Microsoft middleware products, and to permit non-Microsoft middleware products to take on a default status that will override middleware functions Microsoft has integrated into the operating system. Distribution of only one million copies, rather than sales, installation or usage, is a relatively minor threshold in the software industry today, and including this limited qualification in Section III.H. will ensure that Microsoft's affirmative obligations under these provisions will not be triggered by minor, or even nonexistent, products that have not established a competitive potential in the market and that might even be unknown to Microsoft development personnel. The one million copies figure applies in even a more limited fashion to Section III.D. That section requires Microsoft to disclose to software and hardware developers, computer manufacturers and others in the industry certain APIs and other technical information that Microsoft's middleware products use to interoperate with the Windows operating system. The one million copy limitation applies only to disclosures of interfaces for future middleware that has not yet been developed or even conceived. The Department considered the competitive impact of smaller innovators. In fact, the proposed Final Judgment provides protection for nascent middleware products by prohibiting Microsoft from retaliating or discriminating against them, regardless of the number of copies that they distribute.

22. [The letter skips this question.]

## QUESTION

23. Section III.B of the PFJ prohibits Microsoft from engaging in discriminatory pricing of its desktop operating system with OEMs. Does the PFJ also prohibit use of this same kind of discriminatory pricing against server operating systems and other non-Windows software?

## ANSWER

The proposed Final Judgment does not require Microsoft to use uniform terms and conditions when licensing its server operating system or other non-Windows software.

## QUESTION

24. The interim decree proposed by Judge Jackson included a provision precluding Microsoft from taking knowing action to disable or adversely affect the operation of competing middleware software. Does the PFJ contain a comparable provision? If not, what was the Department's rationale for not including this prohibition in the proposed settlement?

## ANSWER

The proposed Final Judgment does not contain an express provision precluding Microsoft from taking knowing action to disable or adversely affect the operation of competing middleware products. As explained more fully in response to question 16, the Department chose not to include this type of provision because it would have given Microsoft a license to interfere with competing middleware as long as it simply notified the competing developer. In addition, it would have been difficult for the Department to enforce the provision because of the constant changes Microsoft makes to its operating system. Many of these changes would have been known by Microsoft to have the unintended consequence of affecting a competing product's interoperability. Instead, the proposed Final Judgment contains provisions that require Microsoft to provide competing middleware with APIs needed to interoperate with the Windows operating system.

## QUESTION

25. Why did the Department choose not to present evidence to the District Court on current PC operating system market developments, including changes in the Internet browser market share since the trial began? Did the Department undertake an investigation of current market developments to determine the impact of the PFJ on the existing market realities? For example, was there an analysis of the impact of the proposed settlement on Microsoft's proposed future products and services?

## ANSWER

Judge Kollar-Kotelly had scheduled an evidentiary hearing on remedy to take place in 2002. The



Department would have had the opportunity to present evidence to the Court at that time. There was no opportunity to present evidence to the Court at an earlier date.

The Department conducted an ongoing evaluation of market developments and the impact of the proposed Final Judgment on existing market realities. One result of this evaluation was to broaden the definition of middleware to include new potential threats to the operating system, including email clients, media players, instant messaging software and future middleware developments. The Department also analyzed the impact of the Court of Appeals' decision and the proposed Final Judgment on Microsoft's future products and services.

## QUESTION

26. The CIS suggests that the District Court's role under the Antitrust Procedures and Penalties Act is limited to reviewing the remedy in relationship to the violations that the United States has alleged in its complaint. *See* CIS at p. 67. Yet the authorities cited for that proposition appear to be cases that were settled before trial. Some observers argue that in this case the District Court should review the settlement in relationship to the Court of Appeals ruling rather than to the violations alleged in the original complaint. Does the Department agree with that assessment?

## ANSWER

Beyond the Department's position set forth in its submissions to the Court, the Department cannot comment on the appropriate review by the Court because the Court's review of the proposed Final Judgment is pending under the Tunney Act.

## QUESTION

27. Has the Department undertaken any studies to determine the effectiveness of its prior consent decree with Microsoft in restoring competition? How do you believe prior obstacles to enforcement of consent decrees with Microsoft are addressed in the PFJ?

## ANSWER

The Department has not conducted a formal study on the effectiveness of the prior consent decree with Microsoft. In its ongoing evaluation of the effectiveness of the proposed Final Judgment, however, the Department did consider the prior consent decree with Microsoft. There has been no determination by a court of obstacles to enforcement of consent decrees with Microsoft. Moreover, the proposed Final Judgment in this case contains some of the most stringent enforcement provisions contained in a modern consent decree. In addition to the ordinary prosecutorial access powers, the proposed Final Judgment requires an independent, full-time, on-site technical compliance team and a provision under which the term of the judgment may be extended by up to two years in the event the Court finds serious, systemic violations.

**QUESTION**

28. Do you believe that current antitrust law is sufficient to guarantee not only competition but timely enforcement in areas such as the software industry?

**ANSWER**

The Department believes that the current antitrust laws are sufficient to guarantee not only competition, but timely enforcement in high-tech areas, such as the software industry.

**QUESTION**

29. What steps, if any, should be taken, legislatively or otherwise, to ensure that the Department has the proper economic and technological resources to enforce the law in the software industry?

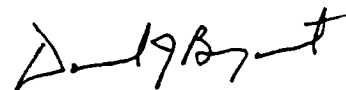
**ANSWER**

The Department does not believe that any changes to the antitrust laws are needed to ensure that the Department has the proper economic and technological resources to enforce the law in the software industry or other high-tech areas. The Department should continue to have the adequate resources to enforce the laws as long as appropriately funded by the Congress.

\* \* \* \*

Please do not hesitate to contact us if we can be of assistance on this or any other matter.

Sincerely,

A handwritten signature in black ink, appearing to read "D. J. Bryant", with a stylized flourish at the end.

Daniel J. Bryant  
Assistant Attorney General

ROBERT H. BORK

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1150 SEVENTEENTH STREET, N. W.  
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December 11, 2001

The Honorable Patrick J. Leahy, Chairman  
Committee on the Judiciary  
United States Senate  
Washington, D.C. 20510

The Honorable Orrin G. Hatch  
Committee on the Judiciary  
United States Senate  
Washington, D.C. 20510

Dear Chairman Leahy and Senator Hatch:

The Proposed Final Judgment (PFJ) in *U.S. v. Microsoft* is a woefully inadequate end to more than 11 years of investigation and litigation against Microsoft Corporation. There is no longer a debate over Microsoft's liability under the antitrust laws. Microsoft has been found liable before the District Court. Microsoft lost its appeal to the United States Court of Appeals for the District of Columbia Circuit sitting *en banc* in a 7-0 decision. Microsoft's petition for a rehearing before the Court of Appeals was refused. Microsoft's petition for *certiorari* before the Supreme Court was also denied. The courts have decided that Microsoft possesses monopoly power and has used that power unlawfully to protect its monopoly.

The case now turns back to the District Court for review under the Antitrust Procedures and Penalties Act – the so-called Tunney Act. Under the Tunney Act the Court must reach an independent judgment on whether or not the settlement is in the “public interest.” The District Court finds itself in an interesting posture in that in the 30 years since the Tunney Act was enacted, it has never been applied in a case which has been litigated and affirmed. What is unique about the application of the Tunney Act in *U.S. v. Microsoft* is that rather than some ambiguous “public interest” standard, the District Court will now be obligated to reach a decision on whether or not the settlement corresponds to the clear guidance of the Court of Appeals.

The court of appeals set out a simple standard for measuring the legal sufficiency of any remedy selected in the *Microsoft* litigation: the remedy must “seek to ‘unfetter [the] market from anticompetitive conduct,’ \* \* \* to ‘terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future.’” *United States v. Microsoft Corp.*, 253 F.3d 34, 103 (D.C. Cir. 2001)(“*Microsoft III*”) (quoting *Ford Motor Co. v. United States*, 405 U.S. 562, 577 (1972), and *United States v. United Shoe Machinery Corp.*, 391 U.S. 244, 250 (1968)). The Court of Appeals was very deliberate in its handling of this case, and its finely crafted opinion manifestly chose its words and precedents with care. In citing the *Ford Autolite* and *United Shoe* cases, the D.C. Circuit underscored the clear guidance of the Supreme Court in monopolization cases.

The D.C. Circuit provided equally straightforward guidance in explaining Microsoft’s liability for illegal monopolization. At the core of the case was Microsoft’s successful campaign to eliminate the dual threats of Netscape’s Navigator web browser and the Java programming language. Both Navigator and Java were “platform threats” to Microsoft’s underlying operating system. Both Navigator and Java served as “middleware.” “Middleware” means that these programs exposed applications programming interfaces (APIs) so that third party applications developers could write applications to Navigator and Java in lieu of the underlying Windows operating system. And because both Navigator and Java ran on operating systems other than Windows they fundamentally threatened the Windows operating system, Microsoft’s core source of monopoly power. The D.C. Circuit could not have been clearer on these points. See *Microsoft III*, 253 F.3d at 53-56, 60. At a minimum any proposed settlement must effectively remedy this problem.

Unfortunately, the remedy accepted by the Antitrust Division of the Justice Department ignores most of the key findings by both the Court of Appeals and the District Court. The PFJ falls far short of the standards for relief clearly articulated by the Court of Appeals and the United States Supreme Court. The PFJ includes provisions that potentially make the competitive landscape of the software industry worse. And, the PFJ contains so many ambiguities and loopholes as to make it unenforceable, and likely to guarantee years of additional litigation.

That the PFJ will hamper Microsoft’s illegal behavior not at all is shown by the reactions of the investment community:

“We have review the Settlement Agreement between MSFT and the DoJ ... the states (and to a lesser degree the DoJ) had talked tough and set expectations for a knock-out victory, and now must accept criticism that they walked away with too little concessions from Microsoft.” Goldman Sachs, 11/2/01

“As we have stated before, we believe a settlement is a best case scenario for Microsoft. And, this settlement in particular seems like a win for Microsoft being that it would preserve Microsoft’s ability to bundle its Internet assets with Windows XP and

future operating systems – a plus for the company. In fact, it appears that Internet assets such as Passport are untouched. Also, as is typical with legal judgments, this settlement is backward looking, not forward looking. In other words, it looks at processes in the past, but not potential development of the future.” Morgan Stanley, 11/02/01

“The deal ... appears to be ‘more, better, and faster’ than we expected in a settlement deal between Microsoft and DoJ. The deal will apparently require few if any changes in Windows XP and leave important aspects of Microsoft’s market power intact.” Prudential Financial, 11/01/01

“With a dramatic win last week, Microsoft appears to be on its way to putting the U.S. antitrust case behind it. The PFJ between the Department of Justice and Microsoft gives little for Microsoft’s competitors to cheer about. ... There is very little chance that competitors could prove or win effective relief from violation of this agreement, in our view.” Schwab Capital Markets, 11/6/01

This takes on particular importance given the state of the software market. Since the end of the trial before the District Court the market has changed substantially:

- Microsoft’s monopolies *are stronger* in each of its core markets with both the Windows operating system and the Office suite now higher than 92 percent and 95 percent, respectively;
- Microsoft has achieved a *new monopoly* in web browsers;
- Competitive forces that may have existed in the past – most notably the Linux operating system – now clearly pose no threat to Microsoft’s monopoly; and
- Microsoft has made clear it intends to further protect and extend its monopoly through a series of initiatives including, Hailstorm (web-services); Windows XP, and .NET.

Some policy makers have adopted the view that settling this case could somehow revive the slowing U.S. economy. This is an absurd proposition. The problem with the PC sector today is that demand has slowed and prices for PC hardware have plummeted (as opposed to Microsoft’s software which has effectively increased in price). It is simply incorrect to equate slowing PC demand with Microsoft’s legal problems. Also, we are unaware of any economic theory that suggests that monopolies maintained by predatory conduct – as opposed to competition and innovation – can spur economic growth. As the Precursor Group recently pointed out: “investor lament about the lack of broadband and the absence of killer applications is the ‘other side of the coin’ to investor glee with the market power and profits of incumbent Bell, Cable, and Microsoft monopolies ... having legal monopolies on the major access points to the Internet is unlikely to maximize innovation and growth that investors are counting on.”

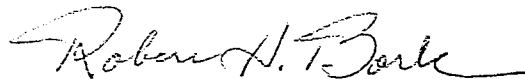
The briefing memorandum offered in support of these views documents general problems with the PFJ and specific section-by-section analysis of the PFJ's provisions. However, this memorandum is meant to be illustrative – not comprehensive – to give policy makers a preview of the issues to be examined under the Tunney Act. The Antitrust Division and Microsoft will continue to insist that the PFJ sufficiently remedies the issues in the case.

Yet these arguments simply cannot be squared with the fact that every independent investment analyst and industry analyst has concluded that this remedy will have no material impact on Microsoft's business.

Policy makers also need to pay attention to the precedent this case establishes. In settling the most important antitrust case in decades through a remedy that will have not impact on the current or future competitive landscape, and absolutely no deterrent effect on the defendant, the Department of Justice has effectively repealed a major segment of the nation's antitrust laws. Moreover, any potential witness with knowledge of anticompetitive conduct in a monopolized market has to weigh the potential benefit of his or her testimony against the likely response of the defendant monopolist. The DOJ's proposed meaningless remedy would insure that no witness would ever testify against Microsoft in any future enforcement action.

The PFJ, in short, places this defendant in a position of effectively being above the antitrust laws, and does so by surrendering the government's victory in the District Court and the unanimous seven-member Court of Appeals. That is a result that should not be countenanced.

Yours truly,

A handwritten signature in cursive script, reading "Robert H. Bork".

Robert H. Bork

RHB:lh

## THE BARKSDALE GROUP

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December 11, 2001

The Honorable Patrick J. Leahy  
Chairman  
Committee on the Judiciary  
United States Senate  
SD-224  
Washington, D.C. 20510

The Honorable Orrin G. Hatch  
Ranking Minority Member  
Committee on the Judiciary  
United States Senate  
SD-224  
Washington, D.C. 20510

Dear Chairman Leahy and Senator Hatch,

I was privileged to have received the invitation to testify at your hearing on Wednesday, December 12, and had looked forward to offering my views about the likely effect of the proposed Microsoft settlement, particularly on the state of innovation in the high-technology industries.

At the time I was asked to testify, it was suggested my testimony might be useful to the committee because of my experience as the CEO of Netscape, and especially because Netscape was founded at a time when Microsoft was first charged with Sherman Act violations. Those of us at Netscape competed with Microsoft at a time when Microsoft was theoretically constrained by a 1995 Consent Decree, and thus I would be in a position to attest to Microsoft's business conduct during a period in which anticompetitive actions would theoretically be restrained.

Moreover, my testimony would have been free of any fear of Microsoft. I am no longer in a business that competes with them. I can afford to tell the truth, and the truth needs to be told.

It is an established legal fact that Microsoft has retaliated against firms like Netscape, Intel, Apple, Real Networks, IBM, Compaq and a host of others which have

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The Honorable Patrick J. Leahy  
The Honorable Orrin G. Hatch  
December 11, 2001  
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These developments have stiffened my resolve to do all that I can to insure that competition and consumer choice are reintroduced to the industry. It is vitally important that no company can do to a future Netscape what Microsoft did to Netscape from 1995 to 1999. It is universally recognized that that the 1995 Consent Decree was ineffective. I respectfully submit that the Proposed Final Judgment ("PFJ"), which is the subject of the hearing, will be even less effective, if possible, than the 1995 Decree in restoring competition and stopping anticompetitive behavior.

Accordingly, Senator Leahy, I am going to follow your suggestion that I help the committee answer one of the central questions:

*If the PFJ had been in effect all along, how would it have affected Netscape? More important, how will it affect future Netscapes?*

Impact on future Netscapes.

As discussed in the attached document, the unambiguous conclusion is that if the PFJ agreed upon last month by Microsoft and the Department of Justice had been in existence in 1994, Netscape would have never been able to obtain the necessary venture capital financing. In fact, the company would not have come into being in the first place. The work of Marc Andreessen's team at the University of Illinois in developing the Mosaic browser would likely have remained an academic exercise.

An innovative, independent browser company simply could not survive under the PFJ. And such would be the effect on any company developing in the future technologies as innovative as the browser was in the mid 1990s.

That leaves the question of whether Microsoft itself would have developed browser technology necessary for Internet navigation. My belief is that Microsoft would not have developed that technology. It is abundantly clear that Microsoft viewed the browser and the Internet itself as the principal threat to their core business of selling operating systems and applications for desktop computers.

This PFJ allows Microsoft to employ the full fury of its multiple monopolies against anyone who would develop a browser or any other technology that might have the potential to challenge any aspects of Microsoft's business. I have reviewed the PFJ, and my impression continues to be that it is a document whose principal purpose is to protect Microsoft from competition, and not to open up the market to competition with Microsoft. I note, again with pleasure, that the remedy proposal by the state Attorneys General who remain as plaintiffs would significantly open the market up to competition.



The Honorable Patrick J. Leahy  
The Honorable Orrin G. Hatch  
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deigned to compete with parts of Microsoft's business. The courts have repeatedly and unanimously found that this atmosphere has led to the stifling of innovation throughout the high-technology sector, harming consumers and the economy. Perhaps worse, Microsoft has created an atmosphere where those who witness violations of the law are afraid to share what they know with law enforcement officials. The certainty of retaliation against these potential witnesses has had, to varying degrees, the effect of obstructing justice. One of the points I would have made had I been able to testify is that the settlement between Microsoft and the Department of Justice would do virtually nothing to protect computer manufacturers and others from Microsoft's retaliation. Which means that, fundamentally, Microsoft's behavior will not be changed by it. The settlement is simply that -- a memorial to the end, not a remedy for the past or for the future.

Over the last five years, the Committee has pushed software companies to step forward and make public their concerns about Microsoft's illegal conduct, to identify how the company's anticompetitive behavior was eliminating competition, discouraging investment and stifling innovation. Witnesses were told - and I was one of them - that policymakers understood that antitrust law enforcement was critical to insuring competition in the software industry. Witnesses were told that cooperation with the government not only made good business sense; it was their public duty, and necessary to insure the illegal conduct was appropriately remedied.

Not surprisingly, many were reluctant, fearful of what would happen to their businesses and their employees. Many that came forward paid a heavy price. Retaliation was meted out in a variety of ways. Meanwhile, the company that broke the law has only grown stronger. The Committee may wish to consider how this result might impact the administration of justice, as well as any potential future testimony in both the legislative and judicial branches of government.

During the Cold War, we used to refer to a concept known as Finlandization. What this referred to was that Finland was nominally free of the Soviet Union, but was so threatened by it, it could not act unilaterally without tempering its actions so as not to offend its giant neighbor which could crush it at will. The technology industry now, and after the settlement with DOJ, is still effectively, Finlandized by Microsoft. It is still dominated, and will still cower in fear of the monopolist unbound. The resolution of the antitrust litigation will to a large degree determine whether or when that atmosphere changes. That may well be a larger issue than the specifics of any proposed settlement. I note with some real satisfaction that the remedy outlined last Friday by the nine state Attorneys General who remain as plaintiffs would have the effect of genuinely constraining Microsoft, and thus liberating the technology industry from the shadow cast by Microsoft.

The Honorable Patrick J. Leahy  
The Honorable Orrin G. Hatch  
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If the PFJ provisions are allowed to go into effect, it is unrealistic to think that anybody would ever secure venture capital financing to compete against Microsoft. This would be a tragedy for our nation. It makes a mockery of the notion that the PFJ is "good for the economy."

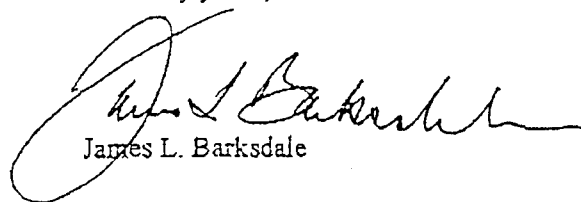
If the PFJ goes into effect, it will subject an entire industry to dominance by an unconstrained monopolist, thus snuffing out competition, consumer choice and innovation in perhaps our nation's most important industry. And worse, it will allow them to extend their dominance to more traditional businesses such as financial services, entertainment, telecommunications, and perhaps many others.

Four years ago I appeared before the committee and was able to demonstrate, with the help of the audience, that Microsoft undoubtedly had a monopoly. Now it has been proven in the courts that Microsoft not only has a monopoly, but they have illegally maintained that monopoly through a series of abusive and predatory actions. I submit to the committee that Microsoft is infinitely stronger in each of their core businesses than they were four years ago, despite the fact that their principal arguments have been repudiated 8-0 by the federal courts.

I hope you will keep these thoughts in mind during your hearings.

A more detailed analysis of my views follows.

Sincerely yours,



James L. Barksdale

JLB/s  
Attachment

### Background on Netscape and the Internet browser.

Many of you know that Netscape was founded by Dr. Jim Clark and Marc Andreessen. Marc had been a participant in National Science Foundation programs in the early 90s at the University of Illinois, where he and his team in 1993 wrote the code that became the first easy to use browser. Even though the Internet and its ancestors had been around since the 1960's, the graphical browser - which allowed non-computer scientists to navigate the Internet - was the technological innovation we had been waiting for. This led to the creation of Netscape in 1994. This triggered an explosion of innovation, and changed all of our lives. I am proud to have served as Netscape's CEO from 1995-1999, when it was acquired by AOL, and very proud of the role Netscape had in changing the world for the better.

A. API Disclosure. The browser was and is a third party application. But it was also a potential platform which exposed Application Programming Interfaces ("APIs") and supported other third party applications. Third party applications writers desired to write applications to the browser platform, because once these applications worked with the browser, they would automatically run on any operating system on which the browser was present. It is well documented that Microsoft was concerned this phenomenon would commoditize Windows - meaning that this would bring about real competition in the operating system market. Introducing competition to a monopolized market would have been exactly the kind of positive development our competition policies welcome.

Of course, the browser could not work without an operating system. We needed Microsoft's cooperation and we needed the Windows APIs necessary to insure Netscape's browser interoperated with Windows.

It was well known that Windows '95 would be a major product release for Microsoft. We contacted Microsoft in the spring of 1995 about obtaining the necessary APIs, the same APIs they were distributing to other 3<sup>rd</sup> party applications writers. Because Microsoft viewed Netscape as a potential competitor, they withheld the necessary APIs from Netscape for an extended period of time - almost a year.

*Question 1. Would the PFJ have compelled the disclosure of the APIs necessary for Netscape's browser to interoperate with Windows?*

Answer: A resounding no. The PFJ would not have compelled meaningful disclosure in a timely way.

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**K I J L M N O P Q R S T U V W X Y Z**

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Litigation ensued. Microsoft denied that it had violated the law in so doing, citing the language of the 1995 Consent Decree. Ultimately, the Court of Appeals held in June, 1998, that under the terms of the 1995 Consent Decree, Microsoft was entitled to bind products together as long as there was a "facially plausible" explanation for having done so. The Court pointedly said at the time that this issue might have been decided differently if it were a Sherman Act case rather than a Consent Decree case. Nevertheless, Microsoft seized upon this Consent Decree opinion and claimed that it could now bundle a ham sandwich as part of Windows if they wanted.

Let me make one point clear: while I believe this was the wrong result, I do not blame Microsoft for attempting to prevail on this point. The fault lies with the Department of Justice for having written a poor agreement with Microsoft in the first place. The agreement was flawed in that it contained language which was at best ambiguous and, at worst, an avenue for Microsoft to flaunt the decree.

The Sherman Act antitrust case against Microsoft was filed in May, 1998. The government alleged that Microsoft's practice of tying the browser and operating system together was illegal. In June, 2001, the Court of Appeals this time said that Microsoft's practice of "commingling" the browser and operating system code together was illegal.

Question 2. *How does the PFJ deal with the issue of binding other software to Windows?*

Answer. Remarkably, the PFJ adopts Microsoft's ham sandwich argument. It contains a definition which says that Windows is whatever Microsoft says it is. The net effect of this is whenever any software is developed which could threaten Microsoft, Microsoft can simply bolt a similar product into Windows and call it all one product. Since this language is more favorable to Microsoft than current law, it is an example of how Microsoft, the defendant in the lawsuit, actually gained affirmative exceptions from current law through negotiations with the Department of Justice.

Once again, I don't blame Microsoft for trying. They're supposed to negotiate the best deal possible. It is the fault of the Justice Department and the various states who agreed to this.

The PFJ not only would not have protected Netscape from Microsoft's predatory conduct. It actually would have provided less protection than any of the legal standards that have existed the past ten years.

C. Distribution and Retaliation. The most important distribution channel in the software business is the OEM channel. Microsoft controls that channel by virtue of having the Windows monopoly. If Microsoft chooses not to distribute Windows to a particular OEM in a timely manner, the OEM simply cannot sell computers.

The OEM channel became the most important distribution channel for Netscape as well. Microsoft used its market power to impede Netscape's ability to distribute

Attachment  
Page 3

browsers. They said they were going to "choke off (our) air supply" and they began to execute on that strategy. OEMs who wanted to feature Netscape's browser were punished by Microsoft. The price of Windows was increased, or the threat of cancelling the Windows license was made.

*Question 3. How does the PFJ protect against retaliation by Microsoft against an OEM or anybody else who would prefer to feature or sell non-Microsoft software?*

Answer: The first thing that must be taken into account is that there is nothing in this remedy which will lead to more competition in the operating system market, so OEMs know that Microsoft's position is more secure as a monopolist than ever before. That fact, juxtaposed with the permanent cancellation threat Microsoft gained by this settlement, is intended to and will freeze any OEM wishing to promote non-Microsoft alternatives. Under this agreement, Microsoft can terminate, without notice, a PC company's Windows license, after sending the PC company two notices that it believes it is violating its license. There need not be any adjudication or determination by any independent tribunal that Microsoft's claims are correct; only two notices to any PC company of a putative violation, and thereafter, Microsoft may terminate *without even giving notice*. This provision means that the PC companies are, at any time, just two registered letters away from an unannounced economic calamity. It will render the PC companies severely limited in their willingness to promote products that compete with Microsoft.

Even though Microsoft is an adjudged monopolist, it is constrained only from certain specified forms of retaliation, presumably empowering it to engage in other forms of retaliation. This formulation is particularly problematic because the protected PC company activities are narrowly and specifically defined. Retaliation against a PC company for installing a non-Microsoft application that does not meet the middleware definition is NOT prohibited; nor is retaliation against a PC company for removing a MSFT application that does not meet the middleware definition.

Microsoft can price Windows at a high price, and then put economic pressure on the PC company to use only Microsoft applications through the provision that Microsoft can provide unlimited consideration to PC companies for distributing or promoting Microsoft's services or products. The limitation that these payments must be "commensurate with the absolute level or amount of" PC company expenditures is hollow, since there is no cost methodology proposed, and no mechanism to account for costs in any event.

Under the settlement, Microsoft can provide unlimited "market development allowances, programs, or other discounts in connection with Windows Operating System Products." This provision essentially eviscerates the entire scheme of PC company choice, functioning the same way as the rebate provision discussed above, but without any tether or limiting principle whatsoever. Simply put, MSFT can charge \$150 per copy of Windows, but then provide a \$99 "market development allowance" for PC companies that install Windows Media Player as opposed to Real Networks media player.

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Presumably, this is intended to be prescribed by a provision which says that "discounts or their award" shall not be "based on or impose any criterion or requirement that is otherwise inconsistent with ... this Final Judgment," but this circular and self-referential provision does not ensure that the practice identified above is prohibited.

And Microsoft is free to retaliate against PC companies that promote competition by withholding any existing form of "non-monetary Compensation" - only "newly introduced forms of non-monetary Consideration" may not be withheld.

Note that the Wall Street article of December 10 by John Wilke, which discussed why computer makers would not testify before the Senate Judiciary Committee: "None of the computer makers that are supposed to be the chief beneficiaries of the Justice Department settlement agreed to testify. Two major computer makers said in interviews that the proposed settlement's antiretaliation provisions are so weak that they were unlikely to take advantage of its other provisions allowing PC makers to use rival technologies. The government settlement 'leaves Microsoft as the gatekeeper of innovation in the industry,' an executive of one PC maker said last week.

Remember that we are talking about the remedy in antitrust case where the monopolist has been found to have violated the law in spades. Ask yourselves how it is possible that in this remedy Microsoft secured for itself the right to retaliate against anybody.

D. Allowing consumers to exercise real software choice. We believed at Netscape that as long as consumers could exercise real browser choice, Netscape could compete with Microsoft. We even said we could "compete with free". That is, a scenario where our customers paid for browsers and Microsoft gave its browser away for free. We ultimately were unable to compete with a free product that was bolted to the operating system for anticompetitive reasons.

*Question 4. Does the PFJ empower the consumer to make choices about what software to use, and if so, does it require Microsoft to respect those choices in the future?*

Two of the key provisions of the PFJ cited by DOJ as instrumental in restoring competition merely require Microsoft continue to engage in business as usual. First, DOJ points to the provision that allows PC companies and end users to remove "end user access" to Microsoft middleware (i.e. Internet Explorer, Windows Media Player, Windows Messenger, etc). It is important to understand that all "end user access" really means is the ability to remove the "icon" for the middleware application, not the middleware itself. Second, DOJ "grants" the PC companies "flexibility" to add or remove icons on the Windows desktop.

We have been down this road before. OEMs will not exercise choice to merely remove or add icons because that is not a meaningful choice. PC companies have always enjoyed the flexibility to add icons to the Windows desktop. Microsoft

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specifically announced in July that OEMs could remove Internet Explorer icons from the desktop. And Microsoft had previously been ordered by the Court to display such flexibility in 1998. Until the fundamental relationship between Microsoft and the OEMs changes, no OEM will avail themselves of this cosmetic flexibility.

Astonishingly, Microsoft actually secured for itself in the PFJ a provision that allows Microsoft to exploit its "desktop sweeper" to eliminate PC company installed icons by asking an end user if he/she wants the PC company-installed configuration wiped out after 14 days. Thus, the PC company flexibility provisions will only last on the desktop with certainty for 14 days, and after that period, persistent automated queries from Microsoft can reverse the effect of the PC company's installations. The effect of this provision is to severely devalue the ability of PC companies to offer premier desktop space to ISVs - and to undermine the ability of PC companies to differentiate their products and provide consumers with real choices.

So, under this remedy, Microsoft gets to undermine the choices made by PC companies and grants Microsoft a second, third, and truly, infinite bites at the apple, to badger consumers into -- unknowingly or unwittingly -- switching back to Microsoft's software.

The add/remove provisions in the agreement only allow for removal of end user access to Microsoft middleware, not the middleware itself. For example, a PC company or a consumer might choose to eliminate Microsoft's Internet Explorer and replace it with Netscape's Navigator as the default. Under this provision, Microsoft's Internet Explorer - not Netscape's Navigator - is still used in the MyDocuments, MyMusic, MyPictures and Windows Explorer folders. So Microsoft has secured an agreement that insures that Internet Explorer is used even when a consumer has chosen otherwise. And as stated above, Microsoft has secured in this agreement insurance that its browser and other middleware remains on PCs, even if the icon is removed. That will have the effect of guaranteeing that applications writers would not write to Netscape's browser.

As we have seen with the implementation of this approach (i.e., icon removal only) with regard to Internet Explorer in Windows XP, MSFT can use the presentation of this option in the utility to make it less desirable to end users.

And remarkable, the agreement gives Microsoft a new weapon to use in its war to preserve the desktop as its own: it can demand that PC companies include icons for non-MSFT middleware in the add/remove utility.

Ask yourself this: we are talking about a remedy that flows from a case where Microsoft has brazenly violated antitrust laws. Why in the world should Microsoft be able to secure for itself in this remedy a provision that allows consumers to remove non-Microsoft software? This treats the other companies as if they broke the law, not Microsoft.

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CONCLUSION: These are just a few of the provisions that would have affected Netscape or a similar company attempting to have a successful browser business. As stated above, it is my belief that if these provisions had been in effect, it is highly unlikely Netscape would have ever been founded.

If these provisions are allowed to go into effect, no entity will be able to secure venture capital financing to compete against Microsoft in any aspect of its business.

Policymakers must understand the consequences of this proposed action. I regret not being able to share my views directly with the Senate Judiciary Committee, but trust that you will do the necessary due diligence before this badly flawed agreement goes forward in the courts. The policy signal that will be sent if this agreement is finalized is that particularly determined monopolists will be rewarded for their intransigence. Is that really the competition policy of this country?

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September 20, 2001

Steven A. Ballmer  
Chief Executive Officer  
Microsoft  
One Microsoft Way  
Redmond, WA 98052-6399  
Fax No. 425-936-7329

Dear Mr. Ballmer:

In 1998, the Department of Justice and a significant number of state attorneys general filed a lawsuit alleging that Microsoft had monopoly power in the operating system market and that the company had engaged in illegal predatory practices to maintain this monopoly. Our states are not parties to the pending litigation. However, we have a continuing interest in issues relevant to the litigation.

Today we write to you to express our support for concerns raised by the states and the Department of Justice in the litigation. We add our voices to those calling on Microsoft to remedy the antitrust problems that are now evident. We take this action for three reasons.

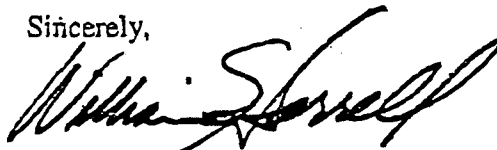
First, as a result of the trial record, we now have the ability to review a complete record of evidence concerning Microsoft's activities over the past several years to maintain its monopoly in the operating system market. Second, the district court's finding of monopoly maintenance was confirmed unanimously by the United States Court of Appeals for the District of Columbia Circuit. Finally, given our understanding of Microsoft's new Windows XP operating system, which is about to be released, we are concerned that aspects of this new product may lead to further erosion of competition in various software markets.

We are concerned that Windows XP may involve additional unlawful attempts by Microsoft to maintain its operating system monopoly. Notwithstanding the notable technological achievements imbedded into some of the products and services offered by Windows XP, Microsoft may have constructed this new product without due regard for relevant legal rulings, and without due regard for other issues involving consumer choice and consumer privacy.

Moreover, there are many state governmental agencies currently using existing versions of Windows, and there are significant expressions of concern that Microsoft will be in a position to withdraw support for products currently in use in favor of Windows XP.

We agree with our colleagues, the litigating states and the federal government, that any anti-competitive aspects of Windows XP should be addressed. As the Court of Appeals succinctly stated, the remedy must, to the extent possible, "unfetter [the] market from anticompetitive conduct, ... and ensure that there remain no practices likely to result in monopolization in the future." We therefore are supportive of efforts of the litigating states and the Department of Justice to incorporate Windows XP into the remedy phase of the remanded case.

Sincerely,



William H. Sorrell  
Vermont Attorney General

On behalf of himself and:

Mark Pryor  
Arkansas Attorney General

G. Steven Rowe  
Maine Attorney General

Mike McGrath  
Montana Attorney General

Phillip McLaughlin  
New Hampshire Attorney General

Sheldon Whitehouse  
Rhode Island Attorney General

**Written Questions for Charles A. James**  
**Chairman Patrick Leahy**  
**"The Microsoft Settlement: A Look to the Future"**  
**December 20, 2001**

1. Jim Barksdale, the former CEO of Netscape, tells us in a written submission that if the proposed settlement had governed Microsoft's behavior ten years ago, he would never have been able to obtain the venture capital to launch Netscape and, even if it did, Microsoft would have been able to crush the company. It is harsh criticism of the proposed settlement that it would have made no difference and that it would allow Microsoft to engage in the same exclusionary practices that extinguished Netscape and crippled Java. Do you think that this criticism is fair and, if not, why?
2. The remedy filed by the non-settling States would require that the agreement be enforced by a court-appointed special master with the authority to monitor Microsoft's complaints, and with the power to investigate, call witnesses, and conduct hearings if the company appears to have violated the agreement. Your proposed settlement provides for a three-member panel paid for by Microsoft that can listen to and investigate complaints, but which lacks the independent authority to convene hearings and examine witnesses. This panel must turn to the Justice Department for any such activity, and its members may not offer testimony themselves in any proceeding. Although the three member panel might be helpful in gathering some information, in terms of actual enforcement, the Justice Department will have to start from scratch with any action. In light of the fact that everyone agrees that this is a rapidly-moving industry, the inherent delays in such a process seem more likely to hamper than to enhance Microsoft's compliance with the decree. Why did you decide to create this unique and limited panel, rather than a more traditional special master?
3. The Court of Appeals specifically held – twice - that commingling the browser and operating system code violated section 2 of the Sherman Act. Yet, the proposed settlement contains no prohibition on commingling code. In your testimony before the Committee, you explained that the Department had never taken the position that Microsoft should be required to remove code from the operating system, and that the proposed settlement is thus consistent with a long-standing position of the Department. That explanation appears to neglects two things: First, the settlement is forward-looking, and second, the court's determination that commingling code was an exclusionary act. Taken together, these facts suggest that a ban on future exclusionary commingling of code is entirely consistent with the Department's position, would provide appropriate relief for the violation found, and would help prevent its recurrence. Do you agree that such a ban on future exclusionary commingling would comport with the Court of Appeals decision? Did you consider such a ban? Do you agree that such a ban on future exclusionary commingling would be would provide appropriate relief for the violation found, and would help prevent its recurrence?

4. There has never been a Tunney Act proceeding after litigation through the court of appeals before. In the first Microsoft-Department of Justice Tunney Act proceeding in 1994, the court suggested that great deference should be given to the appellate court's findings. Do you believe that the Court of Appeals' decision provides useful input to the definition of "public interest" in this unique context?
5. As I mentioned at the Committee's hearing, in describing your settlement, Fortune magazine said: "Even the loopholes have loopholes." The settlement limits the types of retaliation Microsoft may take against PC manufacturers that want to carry or promote non-Microsoft software. By implication the settlement appears to give a green light to other types of retaliation. You responded to my question about retaliation by saying that the settlement would permit collaboration generally approved in the antitrust case law. Please clarify the Department's position a little further:
  - (a) Why does the settlement not ban all types of retaliation?
  - (b) The settlement requires Microsoft to treat PC manufacturers the same in some respects but in other important respects Microsoft is allowed to treat PC manufacturers differently. What are the ways in which Microsoft can treat differently PC manufacturers that carry competing software compared to those that agree to carry Microsoft products exclusively?
  - (c) You referred at the hearing to the fact that the settlement would permit certain collaborative conduct between Microsoft and others. Please explain in detail what types of collaboration are permitted by the decree, and what types are forbidden.
  - (d) Among the exceptions in the proposed settlement to the bans on retaliation, Microsoft is permitted to provide "consideration to any OEM with respect to any Microsoft product or service where that consideration is commensurate with the absolute level or amount of that OEM's development, distribution, promotion, or licensing of that Microsoft product or service." This seems to permit Microsoft to reward OEMs based on whether they carry Microsoft's products or software; this is just the flip side of "retaliation." How is this different from punishing those who fail to accede to Microsoft's demands?
6. In 1995 the Department and Microsoft entered into a Consent Decree. Two years later the Department sued Microsoft for contempt of the Decree when Microsoft and the Department disagreed over the meaning and correct interpretation of certain provisions of the Decree, including the meaning of the word "integrate" as that term was used in the Decree. Given the prior litigation between the Department and Microsoft over the proper interpretation of the 1995 Consent Decree, do you agree that Microsoft and the Department should have a common, explicit understanding of the meaning and scope of this proposed Final Judgment before it is entered?

**Written Questions for Jay Himes**  
**Chairman Patrick Leahy**  
**“The Microsoft Settlement: A Look to the Future”**  
**December 20, 2001**

1. A number of states are still litigating this case against Microsoft, and have submitted a remedy proposal to the district court. That proposal is stronger in significant respects than your proposed settlement. For example, they propose a court-appointed special master with the authority to gather evidence and conduct hearings as part of the enforcement mechanism.  
  
(a) Do you believe that the more stringent provisions sought by the litigating states are not in the public interest?  
  
(b) Did you consider restrictions similar to those sought by the non-settling parties or did you think that Microsoft would not agree to them?
2. The Court of Appeals found that Microsoft’s deception of Java developers and “pollution of the Java standard” constituted exclusionary practices in violation of Section 2 of the Sherman Act, and eliminated its competitive presence in the desktop realm. Unlike Navigator, Java may still be a viable competitive force, in other arenas. What provision, if any, in the settlement agreement prohibits Microsoft from repeating such an act?
3. As I understand the proposed settlement, Microsoft need only disclose APIs and documentation to middleware developers when Microsoft itself has a competing product. Some critics say this would allow Microsoft to determine the pace of innovation on the desktop by simply deciding not to develop or market competing products until it is ready with its own product – or until it has swallowed up a likely competitor. Allowing Microsoft, in essence, to determine the pace of desktop innovation would not aid the software industry generally, and not benefit consumers. How do you respond to this criticism?
4. A loophole seems to be created by the exception to the requirement of APIs and documentation disclosure. Microsoft is supposed to disclose APIs, documentation, and communications protocols to permit interoperability of middleware and servers with Windows operating systems. But Microsoft does not need to disclose such information if it would, *in Microsoft’s opinion*, compromise the security of various systems, which are very broadly defined. What do you say to the critics who fear that this loophole may swallow the API disclosure requirement?
5. The non-settling states’ proposed remedy requires Microsoft to release technical information necessary for middleware to be able to interoperate with Windows as soon as Microsoft gives its own developers that information. The proposed settlement only

requires such disclosure when Microsoft puts out a major test version of a new Windows release. Presumably promotion of competition is the animating idea behind this provision, so why did you not insist that other non-Microsoft developers have this information at the same time Microsoft developers did?

6. In 1995 the Department of Justice and Microsoft entered into a Consent Decree. Two years later the Department sued Microsoft for contempt of the Decree when Microsoft and the Department disagreed over the meaning and correct interpretation of certain provisions of the Decree, including the meaning of the word "integrate" as that term was used in the Decree. Given the prior litigation between the Department and Microsoft over the proper interpretation of the 1995 Consent Decree, do you agree that Microsoft and the settling plaintiffs should have a common, explicit understanding of the meaning and scope of this proposed Final Judgment before it is entered?
7. Do you agree that the meaning and scope of the proposed Final Judgment as agreed upon by the settling plaintiffs and Microsoft should be precise, unambiguous and fully articulated so that the public at large can understand and rely on your mutual understanding of the Judgment?
8. If Microsoft were to disagree with the settling plaintiffs' interpretation of one or more important provisions of the proposed Final Judgment, would you consider that to be a potentially serious problem?
9. Do you agree that it would be highly desirable to identify any significant disagreement between Microsoft and the settling plaintiffs over the correct interpretation of the proposed Final Judgment now, before the Judgment is entered by the Court, rather than through protracted litigation as in the case of the 1995 Consent Decree?
10. Does the Competitive Impact Statement set forth the settling plaintiffs' definitive interpretation of its proposed Final Judgment with Microsoft?
11. Has Microsoft informed the settling plaintiffs that it has any disagreement with the interpretation of the Final Judgment as set forth in the Competitive Impact Statement?
12. Can the public at large rely upon the Competitive Impact Statement as the definitive interpretation of the nature and scope of Microsoft's obligations under the Final Judgment?
13. If the public cannot rely on the interpretation of the proposed Final Judgment as set forth in the Competitive Impact Statement, then what is the mutually understood and agreed-upon interpretation of the meaning and scope of Microsoft's obligations under the Final Judgment?

**Written Questions for Charles F. Rule**  
**Chairman Patrick Leahy**  
**“The Microsoft Settlement: A Look to the Future”**  
**December 20, 2001**

1. In your 1997 testimony on the first Microsoft-Department of Justice consent decree, you said that “it seems a bit shortsighted (or perhaps even hysterical) to believe that Microsoft is such a juggernaut that putting extra sand in its saddle bags is justified to even up the odds for the competition.” In light of the fact that the Court of Appeals found that Microsoft violated Section 2 of the Sherman Act, abusing its operating system monopoly to the detriment of consumers, do you still believe that it is “hysterical” to inquire into, and seek to end, the company’s anticompetitive practices?
2. The Tunney Act requires that Microsoft file with the district court “any and all written or oral communications by or on behalf of [Microsoft] . . . with any officer or employee of the United States concerning or relevant to such proposal, except that any such communications made by counsel of record alone with the Attorney General or the employees of the Department of Justice alone shall be excluded from the requirements of this subsection.” You have recently been named as counsel of record; do you believe that this provision requires disclosure of communications by you to the Justice Department prior to the date upon which you became counsel of record? Do you believe it requires disclosure of contacts made on behalf of Microsoft to members of Congress? How do you define “concerning or relevant to” the proposed settlement? Do you believe that it covers anything more than the actual negotiations of the decree?
3. Microsoft’s retaliation against OEMs that resisted carrying Microsoft’s products featured largely in the evidence at trial, and the proposed settlement seems to address the Court of Appeals’ holding that such retaliation violated Section 2 of the Sherman Act. While the settlement does state that Microsoft cannot retaliate against an OEM that is supposing a competing operating system or middleware, there is also a “carve-out” to that restriction, which permits Microsoft to provide “consideration to any OEM with respect to any Microsoft product or service where that consideration is commensurate with the absolute level or amount of that OEM’s development, distribution, promotion, or licensing of that Microsoft product or service.” This seems to permit Microsoft to reward OEMs based on whether they carry Microsoft’s products or software; this is just the flip side of “retaliation.” How is this different from punishing those who fail to accede to Microsoft’s demands?
4. Microsoft is given 12 months to come into compliance with this proposed settlement; what tasks must it actually undertake that will require so much time?
5. The proposed settlement agreement provides that Microsoft’s disclosure of APIs and documentation for an updated version of Windows in a “timely manner”, and “timely



manner” seems to be defined as the time at which Microsoft makes the new Windows version available to 150,000 or more beta testers. Does Microsoft routinely send beta test versions to so many testers? When has it done so in the past? Can’t Microsoft avoid the disclose provision by simply limiting the number of beta testers?

6. If a PC manufacturer decides that it would like to remove Windows Moviemaker, is that action protected from the ban on retaliation in the proposed settlement? If a representative of a PC manufacturer or a software developer testified before this Committee or before the district court in the on-going states’ case, would the settlement ban retaliation against them?
7. Software developers that take advantage of the middleware API disclosure are required by the proposed settlement to cross-license their products back to Microsoft. Presumably this is of great benefit to Microsoft, but how does it fit into remedying the antitrust violations found in court?
8. The provision of the proposed statement addressing the availability of server communications protocols refers to protocols that are “used to interoperate natively, i.e., without the addition of software code to the client operating system product, with a Microsoft server operating system product.” I am confused about the meaning of “natively,” and the Competitive Impact Statement does not clarify it. As the issue of Microsoft’s possible abuses in the server arena are even now before the European Union’s antitrust enforcement branch, I am interested to know precisely what your proposal accomplishes, and whether it addresses the EU’s concerns as well.
9. The proposed settlement’s prohibition on retaliation against software developers creates an exception from that prohibition for agreements that “are reasonably necessary to and of reasonable scope and duration” in connection with obliging a developer to use, distribute, promote, or develop software for Microsoft. What do you envision that exception to cover, and more importantly, what does it leave within the ban against retaliation?
10. The proposed settlement permits the removal of the Internet Explorer icon, but as I understand it, even if a user chooses to remove Internet Explorer, IE will continue to pop up in MyDocuments, MyMusic, and MyPictures. Is this understanding correct, and if so, how can a user ever be free of Internet Explorer?
11. In 1995 the Department and Microsoft entered into a Consent Decree. Two years later the Department sued Microsoft for contempt of the Decree when Microsoft and the Department disagreed over the meaning and correct interpretation of certain provisions of the Decree, including the meaning of the word “integrate” as that term was used in the Decree. Given the prior litigation between the Department and Microsoft over the proper interpretation of the 1995 Consent Decree, do you agree that Microsoft and the Department should have a common, explicit understanding of the meaning and scope of

this proposed Final Judgment before it is entered?

12. Do you agree that the meaning and scope of the proposed Final Judgment as agreed upon by the Department and Microsoft should be precise, unambiguous and fully articulated so that the public at large can understand and rely on your mutual understanding of the Judgment?
13. If Microsoft and the Department were to disagree about the correct interpretation of one or more important provisions of the proposed Final Judgment, would you consider that to be a potentially serious problem?
14. Do you agree that it would be highly desirable to identify any significant disagreement between Microsoft and the Department over the correct interpretation of the proposed Final Judgment now, before the Judgment is entered by the Court, rather than through protracted litigation as in the case of the 1995 Consent Decree?
15. Can the public at large rely upon the Department's Competitive Impact Statement as the definitive interpretation of the nature and scope of Microsoft's obligations under the Final Judgment? If not, then what is the mutually understood and agreed-upon interpretation of the meaning and scope of Microsoft's obligations under the Final Judgment?
16. Does the Competitive Impact Statement accurately reflect Microsoft's interpretation of the proposed Final Judgment?
17. Recognizing that the Department's Competitive Impact Statement cannot address every conceivable issue that may arise in the future concerning the proposed Final Judgment, is there anything stated in the Competitive Impact Statement with which Microsoft disagrees?
18. Has Microsoft informed the Department that it has any disagreement with the Department's interpretation of the Final Judgment as set forth in the Competitive Impact Statement?
19. Does Microsoft disagree with anything stated in the Department's Competitive Impact Statement concerning the meaning and scope of the proposed Final Judgment?
20. Will you commit on behalf of Microsoft to inform this Committee in writing of each and every statement in the Department's Competitive Impact Statement with which Microsoft disagrees? Will you commit to do so within the next 15 days so that the public can understand what disagreements Microsoft has with the Competitive Impact Statement before the Tunney Act comment period expires?
21. Was there anything in Assistant Attorney General James' testimony before this

Committee concerning the meaning and interpretation of the proposed Final Judgment with which Microsoft disagrees?

22. The Department's Competitive Impact Statement states at page 38 that: "if a Windows Operating System Product is using all the Communications Protocols that it contains to communicate with two servers, one of which is a Microsoft server and one of which is a competing server that has licensed and fully implemented all the Communications Protocols, the Windows Operating System Product should behave identically in its interaction with both the Microsoft and non-Microsoft servers." Does Microsoft agree that this accurately states one objective of Microsoft's obligations under section III(E) of the proposed Final Judgment?
23. The Department's Competitive Impact Statement states at page 36 that: "Section III.E. will prevent Microsoft from incorporating into its Windows Operating System Products features or functionality with which its own server software can interoperate, and then refusing to make available information about those features that non-Microsoft servers need in order to have the same opportunities to interoperate with the Windows Operating System Product." Does Microsoft agree that this accurately states one objective of Microsoft's obligations under section III(E) of the proposed Final Judgment?
25. The Department's Competitive Impact Statement states at page 37-38 that: "Because the Communications Protocols must be licensed 'for use' by such third parties, the licensing necessarily must be accompanied by sufficient disclosure to allow licensees fully to utilize all the functionality of each Communications Protocol." Does Microsoft agree that this accurately states one objective of Microsoft's obligations under section III(E) of the proposed Final Judgment?

**Questions for Assistant Attorney General Charles A. James**

1. One of the principal concerns voiced by critics of the Proposed Settlement is that it lacks an effective enforcement mechanism. These critics suggest that some type of fast-track enforcement mechanism, such as the appointment of a special master, is necessary to ensure compliance. Could you please explain: First, why you believe the enforcement avenues provided for by the Proposed Settlement are sufficient; and, Second, how you envision effective enforcement actually being carried out in the real world?
2. Because the three-person Technical Counsel created by the Proposed Settlement has no enforcement powers, won't the level of enforcement of the Proposed Settlement depend principally on how proactive the Department and State Attorneys General are in dedicating resources and attention to prompt and effective oversight and enforcement? What resources does the Department plan on committing to enforcement of the Proposed Settlement?
3. In my opening statement, I raised the issue of prompt and effective enforcement in high-technology markets. As the D.C. Circuit clearly recognized, the passage of time frequently overtakes alleged anticompetitive actions, making them – in the D.C. Circuit's language – "obsolete" before a remedy is devised and implemented. In your view, what can be done to minimize this problem and ensure that antitrust remedies are developed early enough to provide meaningful relief?
4. Could you explain the pros and cons of having the enforcement function performed by governmental agencies as opposed to a special master or adjudicatory panel of some type?
5. Could you also explain why you oppose – assuming that you do oppose – an alternate or additional enforcement mechanism?
6. As you know, I believe that one important aspect of the Internet is the freedom that consumers have to choose where to go and what websites to visit. Currently, consumers can choose to go to whatever websites they want. Commentators and industry participants argue that there is a legitimate fear that an Internet mediator might – for one reason or another – decide to limit access to certain sites while traffic is directed to other sites, or decide that certain sites will be treated differently than other sites in ways that push consumers in the direction of favored sites instead of leaving the choice entirely and fairly to consumers. Who do you believe should choose where a consumer can go online, the consumer or the Internet mediator, be it an Internet service provider, a software company, or a cable or satellite company? Also, could you please explain whether and why you believe this is an important competition policy concern?
7. Some critics claim that the only real penalty Microsoft faces for violating the Proposed Settlement is the extension of the terms of the Settlement for two additional years. Is that an accurate criticism; and, if not, could you please briefly explain the penalties faced by Microsoft if it fails to abide by the Proposed Settlement?

8. Could you please expand on why you believe the Department has sufficient expertise to accurately evaluate the competitive implications of software design and other technical development choices? Additionally, specifically what has the Department done to ensure that it has the expertise necessary to assess at an early stage both the lawfulness and potential anticompetitive effects of highly-technical actions taken by companies such as Microsoft? Does the Department have a specific plan for allocating resources or personnel to develop the necessary expertise to identify and take effective action while potential antitrust problems are still on the horizon?
9. In his written testimony (pp. 18-19), Mr. Himes of the New York State Attorney General's Office briefly discusses the importance of the Proposed Settlement's definition of "Middleware." The D.C. Circuit defined middleware very simply as "software products that expose their own APIs [or 'Application Programming Interfaces']." *Microsoft*, 253 F.3d at 53. Could you explain why the Proposed Settlement adopts a narrower, two-prong definition? Could you also further explain the distribution threshold contained in the definition of "Non-Microsoft Middleware Products," requiring that – to meet the definition – at least one million copies of the Middleware Product have been distributed within the United States during the previous year? Will this threshold provision disadvantage innovation among start-up entrepreneurs or those who develop software for highly-specialized markets as some have criticized? Is there some other way to address the concerns underlying this "one million copy" threshold?
10. I found Mr. Jim Barksdale's letter noteworthy in several respects, but am particularly interested in his claim that the Proposed Settlement would not have prevented Microsoft's unlawful actions against Netscape. Could you please discuss whether the Proposed Settlement would have prevented the actions taken by Microsoft against Netscape that the D.C. Circuit held to be unlawful had the Proposed Settlement been in existence in 1995, and, if so, how?

#### Questions for Jay Himes

1. I realize that you support the Proposed Settlement on the basis that it compares favorably to the set of remedies that many predict would have resulted from further litigation. However, setting that aside for the moment, could you tell us what particular merit – if any – you see in the Remedial Proposals filed by the non-settling states?
2. Please expand specifically on the pros and cons of the various proposals for alternative enforcement mechanisms that were considered and rejected in the settlement discussions. In particular could you give us your view of the provision, contained in the non-settling parties' Remedial Proposal, that would provide for a special master?
3. Please explain, from the perspectives of the settling State plaintiffs, whether and how the

Proposed Settlement sufficiently protects against Microsoft leveraging its monopoly power in operating systems into the Internet-based services market and the server market?

### Questions for Charles F. "Rick" Rule

1. Concerns have been voiced about potential "loopholes" that might be created by ambiguities in various definitions that are fundamental to determining Microsoft's responsibilities under the settlement. Do you agree that the "Competitive Impact Statement" accurately memorializes the spirit and underlying considerations of the Proposed Settlement agreement; and do you further agree that it should be used as an authoritative interpretive guide in settling disputes about the practical application of the Proposed Settlement?
2. Could you please identify the specific aspects of the Competitive Impact Statement that you believe do *not* accurately represent Microsoft's understanding of the Proposed Settlement? And, to the extent you believe that the Competitive Impact Statement is inaccurate, would Microsoft be willing to provide a detailed description of these perceived inaccuracies along with specific language describing Microsoft's understanding of the issue, language, or provision, the accuracy of which Microsoft disputes?
3. In your written testimony (p. 9) you briefly address the Proposed Settlement's prohibition of retaliation by Microsoft against computer makers. You summarize the provision in the settlement stating that "Microsoft has agreed not to retaliate against computer makers who ship software that competes with anything in [Microsoft's] Windows operating system." *Id.* Concerns, however, have been raised regarding perceived limitations on this anti-retaliation provision. Could you explain either why the perceived caveats were included in the anti-retaliation provision as well as why you believe that these perceived caveats do not *actually* allow Microsoft to engage in substantial retaliation against computer makers?
4. Is it your position that the anti-retaliation provision does in fact prohibit Microsoft from *all* forms of retaliation against computer software makers that choose to ship software that competes with Microsoft products; and, if not, how do you answer the criticisms that the provision is insufficient to effectively prevent retaliation?
5. Several media sources and commentators have reported that major computer makers – or "OEMs" – such as Hewlett Packard, Compaq, Dell, and Gateway, are heavily dependent on Microsoft, which – some have argued – may explain the lack of vocal opposition by these companies to the Proposed Settlement. With this in mind, how can the Proposed Settlement's substantial reliance on these companies to incorporate software that competes with Microsoft products on the computers they distribute be trusted to result in actual competition in the middleware market?

6. Could you please explain, in detail, what incentives you believe will actually lead OEMs to install software that competes against Microsoft software? Are you aware of particular competing software that OEMs might currently wish to install in favor of similar Microsoft products?
7. With respect to concerns raised regarding the lack of a strong enforcement mechanism in the Proposed Settlement, could you please expand upon the reasons that you believe the Proposed Settlement ensures effective enforcement? Could you also explain your view of how enforcement will occur? Finally, could you explain why – assuming that this is your position – the proposed alternative enforcement mechanisms are either unnecessary, undesirable, or both?

### **Questions for Professor Lawrence Lessig**

1. In your book, you make the case for keeping the Internet “neutral and open.” Could you briefly describe the danger that you foresee, in both a competition and a larger policy context, as consumers migrate to higher capacity connections from our current narrowband connections?
2. One concern I have consistently raised elsewhere, including in merger and monopolization contexts, has been possible limitations being placed on consumer freedom by an access provider, whether an Internet service provider, a cable company, a satellite company, or another Internet access facilitator. If there is a legitimate fear that an Internet mediator might – for one reason or another – decide to limit access to certain sites or drive traffic to other specified sites? If so, what do you believe to be the best method of safeguarding and preserving the freedom of the Internet?
3. As you know, on the Internet, anyone can self-publish their music, their artwork, their writings, and those who are interested in those works can have access to them, and neither the creator nor the consumer necessarily need the mediation of a publisher. Works that are important to a few, but cannot make it in a traditional publishing context, have a place for their fans on the Internet. I have said elsewhere that it would be a great shame if the wide-open access available on the Internet were narrowed down in the way the offline world often is. Could you please explain who you believe should choose where a consumer can go online, the consumer or the Internet mediator, be it an Internet service provider, a software company, or a cable or satellite company, and could you explain why this is an important question?

### **Questions for All Witnesses on Panel III**

1. Both commentators and several witnesses (in their written testimony) defend the Proposed Settlement by arguing that its terms are as good as – or even better than – what would have been obtained through further litigation. Several have also pointed out that it would take at least two more years to get a remedy in place by means of litigation. Could

you please explain whether and why you believe that further settlement negotiations or litigation would be in the public interest?

2. In light of the number of claims from the original complaint that the D.C. Circuit found to lack merit, is it reasonable to believe that any judgement resulting from further litigation would be significantly better than the Proposed Settlement?
3. At the hearing, I emphasized the need for prompt antitrust enforcement in quickly-evolving markets. Could you please explain whether and why you believe that the benefits of having an imperfect settlement now are outweighed by those of having a possibly better settlement at some point in the future?



**JUDICIARY COMMITTEE HEARING ON MICROSOFT SETTLEMENT**

**QUESTIONS FROM SENATOR KOHL**

**Panel I - Charles James**

1. Mr. James, a unanimous Court of Appeals held that Microsoft has violated our antitrust laws by illegally maintaining its monopoly. It seems pretty common sense that if we want to fix that violation, the settlement you are advocating should: (1) end the unlawful conduct; (2) avoid a recurrence of the violation; and (3) and undo the anticompetitive consequences of the illegal behavior. Indeed, the Supreme Court has said that we should “deny to the defendant the fruits” of its illegal conduct. As you know, when this case was first filed, one of the main problems was that Microsoft’s illegal conduct had nearly driven a competing maker of Internet browsing software – Netscape Navigator – out of business. But today, Microsoft has a greater than 85% share of browsing software. And Netscape is no longer in business as an independent company and no longer is a serious threat as a competing platform.

So I have the following questions: how does this proposed settlement proposal in any way deny Microsoft the gains resulting from its illegal, anti-competitive conduct? Does it do anything, for example, to undo Microsoft’s victory in the “browser wars”?

2. Five years from now do you think it is likely that Microsoft will still have 95% of the operating system market? If so, should this concern us?

3. We are right now in the middle of the holiday shopping season, and millions of Americans are going to the computer stores to buy new computers. When they reach the store, they have a choice of many different machines made by many different computer manufacturers, such as Compaq, Dell, Gateway, IBM, and HP, to name a few. But when it comes to the software that operates the machine they face a very different picture. With the exception of the machines sold by Apple, the consumer has no choice but to buy a computer pre-loaded with Microsoft's Windows operating system.

Is there anything in the proposed settlement agreement likely to change this picture? Why can't consumers have the same competitive choices in computer software – specifically operating system software – as they have today with respect to deciding which machine to buy?

4. Critics of the proposed settlement claim it is full of loopholes, and that these loopholes will make it easy for Microsoft to evade its terms. I'd like to focus on one thing critics argue is an unnecessary loophole. The settlement contains an important provision that lets computer makers load certain types of non-Microsoft software on their machines without any fear of retaliation from Microsoft. But Microsoft can retaliate in some instances. For example, only competing software that distributed at least one million copies in the United States in the last year receives protection. No such protection is imposed upon competing software which has distributed less than one million copies.

Commenting on this provision in the Washington Post, James Barksdale, the founder of Netscape, wrote “Anyone who understands the [computer] industry knows this is no protection, for the new inventor will always be steam-rolled by the powerful Microsoft. The dreamers and tinkers whose better mousetrap has not yet been proved should just close shop. The ultimate losers are the potential consumers of these lost ideas.”

(a) Why is this limitation found in the settlement? Won't it be difficult for software that has not yet been widely distributed to gain a competitive foothold if Microsoft is not required to allow computer users and manufacturers access to it on the desktop? And why isn't Mr. Barksdale right – aren't consumers the losers if Microsoft is permitted to deny such small, start-up software manufacturers access to the computer desktop?

(b) Please give specific examples of “non-Microsoft middleware products” (as defined in the proposed consent decree, section VI.N) that have distributed at least one million copies in the United States in the past year, and examples of those that have not.

(c) What types of research and/or objective methods are used to measure such distribution today? Which studies or objective criteria did you use to set the one million dollar mark?

5. In the proposed consent decree, with respect to current products, the definition of Microsoft Middleware Product is locked into specific products (section VI.K.1 of the Proposed Final Judgment). Where it is prospective, the definition of Microsoft Middleware Product allows Microsoft to avoid its reach if it does not satisfy all of the elements of the definition (found in section VI.K.2).

(a) Why do you believe this definition is sufficient to restore competition in the middleware market?

(b) Why is the definition of middleware in the proposed consent decree different from the one used by the D.C. Circuit Court of Appeals, or the one used by Judge Jackson in his interim remedy?

(c) Why is MSN Explorer excluded from the current products that constitute Microsoft Middleware Products in section VI.K.1 of the Proposed Final Judgment?

6. Many believe Microsoft is using its operating system monopoly to gain dominance in other types of software products. For example, five years ago, Microsoft had only about a 20% market share in Internet browsing software. Today it has an 86% share. Five years ago, Microsoft had 43% share in word processing software. Today Microsoft Word software has a 94% market share.

What provisions in the settlement will prevent Microsoft from gaining dominant market shares in new software products, just as it has with respect to other types of software?

7(a). Mr. James, if this settlement is adequate to restore competition and remedy Microsoft's illegal conduct, why have nine state attorneys general who initially joined the Justice Department in suing Microsoft refused to sign on to the settlement but have instead proposed their own settlement?

(b) Are you willing to consider modifications to the proposed settlement in order to secure the consent of additional state attorneys general? If so, what modifications would you consider?

8. The proposed consent decree lasts for only five years (unless a Court finds Microsoft has engaged in systematic violations of the decree, in which case it is extended for another two years).

(a) Can you inform me in which past monopoly cases brought by the government where a violation of Section 2 of the Sherman Act has been found, the federal courts have limited their conduct remedies against the monopolist to only five years?

(b) Why have you limited the remedy to five years in this case? How can we be sure that the five year term of the settlement is sufficient to restore competition to this market?

(c) Why do the restraints on Microsoft's conduct in some instances take as long as one year to go into effect?

(d) How likely do you think software developers will be to develop new products based on a decree that will protect them for only five years?

(e) Will you commit initiating new investigations and, if necessary, new court proceedings, if Microsoft behaves in an anti-competitive manner in the future?

**Panel II**

**For Rick Rule**

1. Mr. Rule, in the past your client Microsoft has been adamant in denying it was a monopolist – despite its 95% share of computer operating systems – and that it in any way violated the antitrust laws. Now, the unanimous D.C. Circuit Court of Appeals has ruled that Microsoft indeed is a monopolist and indeed acted illegally to maintain its monopoly. Will this ruling – and Microsoft’s experience in this litigation – in any way chasten Microsoft into behaving more responsibly? Is Microsoft now willing to recognize that it is a monopolist and, as a result, has obligations to deal with competing businesses in a way that would not exist if did not have monopoly power in its business?

2. Please identify for us five specific ways in which the proposed settlement, once it is in force, will compel Microsoft to change its business practices in a manner which will benefit consumers.

3. The proposed consent decree contains prohibitions on Microsoft retaliating against computer makers who choose to install in their machine software products that compete with software made by Microsoft. But many wonder if Microsoft will be able to offer financial incentives to accomplish essentially the same thing. For example, could Microsoft offer to pay incentive amounts to computer makers who feature or promote Microsoft software on their machines?

4. One important issue the settlement was intended to address was Microsoft's ability to penalize computer makers that load non-Microsoft software onto their machines. Under the settlement, can Microsoft still bar a computer maker from putting WordPerfect word processing software or Quicken financial software pre-installed on their machine? If so, why isn't Microsoft's ability to place such restrictions on computer makers a problem for competition?

**For Jay Himes**

Mr. Himes, as you know, nine of your fellow states that originally joined you and the federal government in suing Microsoft have refused to consent to this settlement, and, just last Friday, proposed additional remedies. Why did these other states split ranks with you and the federal government? Would you be willing to consider modifications to this proposed settlement in order to gain their assent?

**Panel III**

**For Lawrence Lessig**

1. Professor Lessig, do you believe this settlement is adequate to restore competition in the computer software industry? Why or why not?
  
2. (a) Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? If so, what are they?  
  
(b) Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you believe should be fixed before it is approved? If so, what are they?
  
3. Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software does not apply with respect to software which has distributed less than one million copies. Are you concerned about this limitation?



**For Mark Cooper**

1. Do you believe this settlement is adequate to restore competition in the computer software industry? Why or why not?

2. (a) Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? If so, what are they?

(b) Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you believe should be fixed before it is approved? If so, what are they?

3. Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software does not apply with respect to software which has distributed less than one million copies. Are you concerned about this limitation?

**For Michael Szulik**

1. Do you believe this settlement is adequate to restore competition in the computer software industry? Why or why not?

2. (a) Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? If so, what are they?

(b) Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you believe should be fixed before it is approved? If so, what are they?

3. Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software does not apply with respect to software which has distributed less than one million copies. Are you concerned about this limitation?

4. Mr. Szulik, your company, Red Hat, makes a competing operating system, Linux. Will this settlement make it easier for you to compete with Microsoft? If so, how?

**For Mitchell Kertzman**

1. Do you believe this settlement is adequate to restore competition in the computer software industry? Why or why not?
  
2. (a) Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? If so, what are they?  
  
(b) Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you believe should be fixed before it is approved? If so, what are they?
  
3. Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software does not apply with respect to software which has distributed less than one million copies. Are you concerned about this limitation? Won't this provision make it difficult for small or start-up software manufacturers that make software that competes with Microsoft's products to gain access to the computer desktop?

**For Jonathan Zuck**

1. Do you believe this settlement is adequate to restore competition in the computer software industry? Why or why not?

2. (a) Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? If so, what are they?

(b) Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you believe should be fixed before it is approved? If so, what are they?

3. Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software does not apply with respect to software which has distributed less than one million copies. Are you concerned about this limitation?

4. Mr. Zuck, your organization, which is one of several trade associations representing smaller software manufacturers, has been generally supportive of this settlement, while other competitive software manufacturers have been very critical. Why doesn't your organization share the concerns of many other smaller software manufacturers?

5. Explain the principal ways this settlement will bring more competition to the software market.

**"The Microsoft Settlement: A Look To The Future"**

Senator DeWine

Questions To Witnesses

**I. Senator DeWine's Questions for The Honorable Charles James, Assistant Attorney General for the Antitrust Division:**

1. The term of the proposed settlement is only five years, while many other antitrust consent decrees last for ten years. The Department has suggested that a shorter time period is justified because this industry changes rapidly and a longer decree may not be warranted after five years. Given that the Department of Justice has the ability to go to the court and seek to modify a consent decree or terminate it if market conditions warrant such a change, why not impose a longer period of enforcement, and then decide later if it needs to be modified or abandoned?
2. As the Court of Appeals in this case noted, the Supreme Court has indicated that a remedies decree in an antitrust case must seek to "unfetter a market from anticompetitive conduct," "terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future." Do you believe that this is the appropriate standard to use? If so, do you believe the proposed final judgment denies Microsoft the fruits of its illegal acts? Specifically, can you discuss whether Microsoft has been denied the fruits of its effort to maintain a monopoly in the operating system?
3. The proposed settlement has some prohibitions against Microsoft retaliating against computer manufacturers that place competing software on their computers—these provisions are intended to allow manufacturers to offer non-Microsoft products if they choose. I understand that Microsoft currently offers incentives to computer manufacturers if they can get computers to "boot up" quickly. Some believe that computer manufacturers will not want to slow down the start-up time by placing additional software on the computer because they will risk losing the incentive payment. Does the proposed settlement deal with this problem?
4. The Appellate Court noted that the applications barrier protects Microsoft's operating system monopoly. The Court stated that this allows Microsoft the ability to maintain its monopoly even in the face of competition from potentially "superior" new rivals. In what manner do you believe the proposed settlement addresses the applications barrier?

5. Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don't want them. This potentially deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, it seems that software developers are more likely to write their programs to operate on Microsoft's middleware if they know that the Microsoft middleware will always be on the computer whereas competing products may not be. Even if consumers are unaware that code is commingled, should we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code?
6. Many believe that this settlement proposal merely requires Microsoft to stop engaging in illegal conduct, but does little in the way of denying Microsoft the benefits of its bad acts. First, how would you answer these critics? Is this just a built-in reality of civil antitrust remedies, i.e., that they don't aim to punish? And second, do you believe the remedy here is strong enough to dissuade other potential monopolists from engaging in the type of conduct in which Microsoft engaged?
7. Nine states didn't join with the Department of Justice's proposed final judgment because they didn't believe it adequately addressed competitive problems. These states recently filed their own remedy proposals. These states assert that one fruit of Microsoft's illegal conduct is Microsoft's dominant share of the internet browser market. They propose to deny Microsoft this benefit of its violations by requiring it to open-source the code for Internet Explorer. What do you believe the competitive impact of such action would be?
8. Given Microsoft's monopoly power in the operating system, some believe that merely allowing computer manufacturers to place competing software and icons on the operating system will not impede Microsoft's ability to capture a dominant share of any product that it binds to its operating system. Do you believe that media players, instant messaging services, and other competing products will be able to compete with similar MS products that are bound to the operating system?
9. Many have criticized the proposed final judgment saying it has loopholes in it that will allow Microsoft to continue operating as it has done in the past. For example, the proposed final judgment clearly seeks to prevent Microsoft from retaliating against computer manufacturers that install competing software onto the computer. However, because the provisions are limited to specific practices or types of software, and apply only to "agreements" between Microsoft and computer manufacturers, many believe that Microsoft will find alternative methods of controlling the practices of computer manufacturers. Do you believe competition would be better served if Microsoft were broadly prohibited from retaliating against computer manufacturers?

10. The Court of Appeals ruled that Microsoft's practices which undermined the competitive threat of Sun's Java technology was an antitrust violation. The remedy proposed by the states that do not support the DOJ's proposed settlement would require Microsoft to distribute Java with its browser as a means of restoring Java's position in the market. Do you believe this would be beneficial to competition? What does the DOJ's proposed settlement do to restore this competition?
11. Definition U. of the Proposed Final Judgment appears to allow Microsoft to determine in its sole discretion what constitutes the operating system. The Court of Appeals left open the possibility of a tying case against Microsoft. Will this provision essentially foreclose any opportunity of bringing a tying claim against Microsoft? Why do you give Microsoft the ability to make this determination?
12. Many antitrust cases involve the appointment of a special master who has some level of enforcement authority. This proposed final judgement does not do that and instead relies primarily upon standard civil and criminal contempt proceedings, as well as a special three person panel. Why has the Division elected not to appoint a special master that may speed effective enforcement, especially given the Division's concern for how rapidly this market changes?
13. The Department of Justice has indicated that one motivation for entering into this settlement was to provide immediate relief and avoid lengthy court proceedings. At the same time, many of the provision of the settlement don't become active for up to 12 months after the settlement is enacted. Given your belief that relief should be immediate, why wait so long for these provisions to become active?
14. One provision of the proposed final judgment requires Microsoft to allow consumers or computer manufacturers to enable access to competing products. However, it appears that III.H. of the Stipulation and VI.N. indicate that for a product to qualify for these protections it must have had a million copies distributed in the United States within the previous year. This seems to run contrary to the traditional antitrust philosophy of promoting new competition. Is this in fact the case? And if so, why are these protections limited to larger competitors?

**II. Senator DeWine's Questions for Jay Himes, Antitrust Bureau Chief, Office of the Attorney General, New York**

1. The term of the proposed settlement is only five years, while many other antitrust consent decrees last for ten years. It has been suggested that a shorter time period is justified because this industry changes rapidly and a longer decree may not be warranted after five years. Given that the Department of Justice has the ability to go to the court and seek to modify a consent decree or terminate it if market conditions warrant such a change, why not impose a longer period of enforcement, and then decide later if it needs to be modified or abandoned?
2. As the Court of Appeals in this case noted, the Supreme Court has indicated that a remedies decree in an antitrust case must seek to "unfetter a market from anticompetitive conduct," "terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future." Do you believe that this is the appropriate standard to use? If so, does the proposed final judgment deny Microsoft the fruits of its illegal acts? Specifically, can you discuss whether Microsoft has been denied the fruits of its effort to maintain a monopoly in the operating system?
3. The proposed settlement has some prohibitions against Microsoft retaliating against computer manufacturers that place competing software on their computers—these provisions are intended to allow manufacturers to offer non-Microsoft products if they choose. I understand that Microsoft currently offers incentives to computer manufacturers if they can get computers to "boot up" quickly. Some believe that computer manufacturers will not want to slow down the start-up time by placing additional software on the computer because they will risk losing the incentive payment. Does the proposed settlement deal with this problem?
4. The Appellate Court noted that the applications barrier protects Microsoft's operating system monopoly. The Court stated that this allows Microsoft the ability to maintain its monopoly even in the face of competition from potentially "superior" new rivals. In what manner do you believe the proposed settlement addresses the applications barrier?
5. Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don't want them. This potentially deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, it seems that software developers are more likely to write their programs to operate on Microsoft's middleware if they know that the Microsoft middleware will always be on the computer whereas competing products may not be. Even if consumers are unaware that code is commingled, shouldn't we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code?



6. Many believe that this settlement proposal merely requires Microsoft to stop engaging in illegal conduct, but does little in the way of denying Microsoft the benefits of its bad acts. First, how would you answer these critics? Is this just a built-in reality of civil antitrust remedies, i.e., that they don't aim to punish? And second, do you believe the remedy here is strong enough to dissuade other potential monopolists from engaging in the type of conduct in which Microsoft engaged?
7. Nine states didn't join with the Department of Justice's proposed final judgment because they didn't believe it adequately addressed competitive problems. These states recently filed their own remedy proposals. These states assert that one fruit of Microsoft's illegal conduct is Microsoft's dominant share of the internet browser market. They propose to deny Microsoft this benefit of its violations by requiring it to open-source the code for Internet Explorer. What do you believe the competitive impact of such action would be?
8. Given Microsoft's monopoly power in the operating system, some believe that merely allowing computer manufacturers to place competing software and icons on the operating system will not impede Microsoft's ability to capture a dominant share of any product that it binds to its operating system. Do you believe that media players, instant messaging services, and other competing products will be able to compete with similar MS products that are bound to the operating system?
9. Many have criticized the proposed final judgment saying it has loopholes in it that will allow Microsoft to continue operating as it has done in the past. For example, the proposed final judgment clearly seeks to prevent Microsoft from retaliating against computer manufacturers that install competing software onto the computer. However, because the provisions are limited to specific practices or types of software, and apply only to "agreements" between Microsoft and computer manufacturers, many believe that Microsoft will find alternative methods of controlling the practices of computer manufacturers. Do you believe competition would be better served if Microsoft were broadly prohibited from retaliating against computer manufacturers?
10. The Court of Appeals ruled that Microsoft's practices which undermined the competitive threat of Sun's Java technology was an antitrust violation. The remedy proposed by the states that do not support the DOJ's proposed settlement would require Microsoft to distribute Java with its browser as a means of restoring Java's position in the market. Do you believe this would be beneficial to competition? What does the proposed final judgment do to restore this competition?
11. Definition U. of the Proposed Final Judgment appears to allow Microsoft to determine in its sole discretion what constitutes the operating system. The Court of Appeals left open the possibility of a tying case against Microsoft. Will this provision essentially foreclose any opportunity of bringing a tying claim against Microsoft? Why do you give Microsoft the ability to make this determination?

12. It has been indicated that one motivation for entering into this settlement was to provide immediate relief and avoid lengthy court proceedings. At the same time, many of the provision of the settlement don't become active for up to 12 months after the settlement is enacted. Given your belief that relief should be immediate, why wait so long for these provisions to become active?
13. One provision of the proposed final judgment requires Microsoft to allow consumers or computer manufacturers to enable access to competing products. However, it appears that III.H. of the Stipulation and VI.N. indicate that for a product to qualify for these protections it must have had a million copies distributed in the United States within the previous year. This seems to run contrary to the traditional antitrust philosophy of promoting new competition. Is this in fact the case? And if so, why are these protections limited to larger competitors?

**III. Senator DeWine's Questions for Charles F. Rule, Fried, Frank, Harris, Shriver & Jacobson, Counsel to Microsoft Corporation, Washington, DC**

1. Mr. Rule, in your testimony you have gone to great length to explain how certain portions of the government's case were dropped or thrown out during the course of litigation. Does Microsoft acknowledge that it violated the antitrust laws?
2. Mr. Rule, many within the high tech industry have argued that the antitrust laws are overly cumbersome when it comes to promoting competition within the fast-changing industry. Is this Microsoft's position?
3. Mr. Rule, what do you believe are the appropriate objectives of remedies in monopolization cases such as this? Do you believe the case law supports a position that monopoly acquisition cases should be treated differently than monopoly maintenance cases? Finally, do you believe this settlement fully achieves the appropriate remedy objectives? If not, in what ways is it deficient? And in what ways, if any, do you believe it reaches beyond the case?
4. Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don't want them. It seems to me that this deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, it seems that software developers are more likely to write their programs to operate on Microsoft's middleware if they know that the Microsoft middleware will always be on the computer whereas competing products will not. Even if consumers are unaware that code is commingled, shouldn't we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code?
5. Many believe that this settlement proposal merely requires Microsoft to stop engaging in illegal conduct, but does little in the way of denying Microsoft the benefits of its bad acts. First, how would you answer these critics? Is this just a built-in reality of civil antitrust remedies, that they don't really aim to punish? And second, do you believe the remedy here is strong enough to dissuade other potential monopolists from engaging in the type of conduct in which Microsoft engaged?

**IV. Senator DeWine's Questions for Professor Lawrence Lessig, Esq., Stanford Law School**

1. Mr. Lessig, you stated in your testimony that an appropriate remedy should try and steer Microsoft toward developing its strategy in regards to the Internet. First, why wouldn't such an objective fall outside the clear confines of the case and thus be an inappropriate goal for a remedy? And second, given the fact that a court found Microsoft to have engaged in significant violations of the antitrust laws, should we be concerned about the company attempting to leverage its operating system monopoly to become dominant at the Internet level?
2. Mr. Lessig, you stated in your testimony that an integral part of the Court's conclusion was its finding that Microsoft had "commingled code" in such a way as to interfere with the ability of competitors to compete on an even playing field. Do you believe the Justice Department's proposed final judgment adequately deals with this anticompetitive conduct?
3. Mr. Lessig, you mention that there are problems with the proposed decree aside from enforcement. What are some of the other areas of concern?
4. Mr. Lessig, what do you believe are the appropriate objectives of remedies in monopolization cases such as this? Do you believe the case law supports a position that monopoly acquisition cases should be treated differently than monopoly maintenance cases? Finally, do you believe this settlement fully achieves the appropriate remedy objectives? If not, in what way is it deficient?

**V. Senator DeWine's Questions For Mark N. Cooper, Ph.D., Director of Research,  
Consumer Federation of America**

1. Mr. Cooper, many have stated that the alternative proposed remedies presented by the litigating states are not justifiable based on the conduct that the Appellate court found to be illegal. Do you agree? If not, how do you believe provisions such as requiring Microsoft to open source its browser code and provide multiple versions of its operating system relate to the conduct that was found to have been illegal?

**VI. Senator DeWine's Questions For Jonathan Zuck, President, Association of Competitive Technology**

1. This case has obviously been very controversial and inspired a great deal of discussion regarding the effectiveness of the antitrust laws, especially within the hi-tech industry. Netscape, for example, vocally opposed Microsoft during this litigation, and many of Netscape's complaints were validated by the courts, and yet Netscape has essentially been defeated. That sort of result has led some to question whether the antitrust laws can be effective in this industry. What lesson do you believe this case teaches in that regard, and what do we say to Netscape?
2. Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don't want them. This potentially deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, software developers are may be more likely to write their programs to operate on Microsoft's middleware if they know that the Microsoft middleware will always be on the computer whereas competing products will not. Even if consumers are unaware that code is commingled, should we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code? Further, what assurances can you give to this Committee that members of your organization will not merely choose to write to the Microsoft middleware, but will fully support competing products as well?

**VII. Senator DeWine's Questions For Matthew J. Szulik, President and Chief Operating Officer, Red Hat, Inc.**

1. Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don't want them. This potentially deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, software developers may be more likely to write their programs to operate on Microsoft's middleware if they know that the Microsoft middleware will always be on the computer whereas competing products will not. Even if consumers are unaware that code is commingled, should we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code?
2. What impact do you believe the Proposed Final Judgment will have on the ability of competing operating systems, such as Linux, to gain traction in the market? Contrast this with the impact you believe a settlement proposal such as that offered by the litigating states would have.

# **VIII. Senator DeWine's Questions For Mitchell E. Kertzman, President and CEO, Liberate Technologies**

1. The Proposed Final Judgement aims to make the middleware market more competitive. Do you believe it is effective in doing so?
2. Do you believe Microsoft will be able to leverage its monopoly in the PC operating system market to capture market share in other operating systems markets such as hand-held devices, navigation devices and servers? Does the proposed settlement address this issue at all, and do you believe the Appellate Court's ruling would permit a settlement that addresses these type of concerns?



**QUESTIONS OF SENATOR RICHARD J. DURBIN  
TO THE DEPARTMENT OF JUSTICE**

1. I understand that the Justice Department officials, representatives of State Attorneys General, and Microsoft lawyers worked around the clock to come to an agreement on this settlement.
  - A. How many meetings were there on the settlement?
  - B. Were the states sufficiently involved in the process?
  - C. Was there anyone in the room during those negotiations who was not affiliated with the parties to the litigation who may have been able to bring another perspective on the terms of the agreement?
2. Now that we are in the 60 day period of the Tunney Act proceeding to determine the public interest aspects of this settlement, what, if any, role do you envision Congress should play?
3. Microsoft is about to settle with about half the states who joined in the original DOJ lawsuit, but the other half of the states are continuing with the court-issued remedies phase of the litigation. Naturally, there may be differences in the remedies in the two different vehicles for closing out this case. How will you reconcile the potential differences between the terms of the settlement accepted by the nine settling state plaintiffs and the remedies to be awarded to the ten non-settling state plaintiffs?

**QUESTIONS OF SENATOR RICHARD J. DURBIN  
TO MICROSOFT**

1. This is an unprecedented settlement for an unprecedented case. The entire world has been, and will continue to, watch every aspect of this case. They will also be watching to see if Microsoft complies with every word of this decree. Assuming this settlement is approved, can you outline the steps that will be taken to ensure compliance with the settlement? Are these steps unique in any way?
  
2. What assurances can the American people have that Microsoft will really be constrained from future anti-competitive practices?

**QUESTIONS OF SENATOR RICHARD J. DURBIN  
TO CONSUMER FEDERATION OF AMERICA**

1. In your mind, what are the most significant shortcomings of this settlement? What will this settlement enable Microsoft to do that you believe they should be prevented from doing?
2. Our economy is currently in a recession and our country is at war. What are the compelling reasons for continuing this litigation against Microsoft rather than finding a way to settle?
3. States that are continuing to pursue litigation want Microsoft to disclose source code for Web browsing functionality now in Windows. This would turn Microsoft's intellectual property into "open-source."
  - A. What are the ramifications to Microsoft and to its competitors if Microsoft is forced to subject its intellectual property to an open-source standard?
  - B. In the future, what should competitors expect from companies that establish dominance in the technology marketplace?

**Questions Submitted For the Record  
by Senator McConnell for  
Witness Charles James**

**Senate Committee on the Judiciary  
Hearing on  
The Microsoft Settlement**

**Wednesday, December 12, 2001  
10:00 a.m.  
106 Dirksen Senate Office Building**

**Question:**

Can you describe how the appeals court ruling impacted the case originally brought by the Department of Justice in 1998?

**Question:**

Can you tell us more about how this agreement came about, or the process involved in reaching a settlement?

**Question:**

Some have criticized the agreement for not going far enough. Do you believe that the proposed settlement compares favorably to-and in some respects may well exceed-the remedy that might have emerged from a judicial hearing?

**Question:**

This litigation has been going on for almost 4 years. Will this settlement accelerate the point in time at which a remedy will begin to take effect?

**Question:**

Assuming the settlement is approved by the court, can you outline the steps that will be taken to ensure compliance with the settlement?

**Question:**

Are you aware of this type of enforcement mechanism being adopted in any other antitrust proceeding?



U.S. Department of Justice

Office of Legislative Affairs

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Office of the Assistant Attorney General

Washington, D.C. 20530

January 24, 2002

The Honorable Patrick Leahy  
Chairman  
Committee on the Judiciary  
United States Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

Please find enclosed the answers to the written follow-up questions posed to Assistant Attorney General Charles James following his testimony before your Committee on December 12, 2001, on "The Microsoft Settlement: A Look to the Future." The Department appreciates the opportunity to provide its views to the Committee on this important topic.

Of course, please do not hesitate to contact us if we can be of any assistance on this or any other matter.

Sincerely,

Daniel J. Bryant  
Assistant Attorney General

cc: The Honorable Orrin G. Hatch  
Ranking Minority Member

## CHAIRMAN LEAHY'S QUESTIONS

### QUESTION

1. Jim Barksdale, the former CEO of Netscape, tells us in a written submission that if the proposed settlement had governed Microsoft's behavior ten years ago, he would never have been able to obtain the venture capital to launch Netscape and, even if it did, Microsoft would have been able to crush the company. It is harsh criticism of the proposed settlement that it would have made no difference and that it would allow Microsoft to engage in the same exclusionary practices that extinguished Netscape and crippled Java. Do you think that this criticism is fair and, if not, why?

### ANSWER

The Department disagrees with Mr. Barksdale's criticism. The essence of the criticism is that the prospects facing start-up firms promoting new software products would be greater if such companies could be guaranteed that they would not face competition from Microsoft. Creating such an environment, however, is not one of the goals of public enforcement of the antitrust laws.

More directly, Mr. Barksdale complains that the proposed Final Judgment fails to stop Microsoft from integrating new functions and capabilities into the Windows operating system. The Department challenged Microsoft's integration of its browser into the operating system in its attempted monopolization and tying claims, neither of which was sustained by the Court. Contrary to Mr. Barksdale's view, the proposed Final Judgment does not create any new rights for Microsoft with regard to product integration. The proposed Final Judgment merely reflects the fact that, in light of the Court's ruling, there is no legal basis for enjoining Microsoft altogether from integrating middleware into its operating system, if that middleware is removable and computer manufacturers and consumers are contractually free to remove it, as a remedy for the violations found in the case. Microsoft remains subject to the antitrust laws with respect to tying and in every other respect.

Mr. Barksdale also makes the curious assertion that Netscape would have fared better without the proposed Final Judgment than with it. The proposed Final Judgment expressly prohibits the very practices Microsoft deployed to impede the emergence of Netscape's Web browser. Thus, had the decree been in effect, Netscape would have had access to Microsoft's APIs in the development process, been able to obtain distribution through computer manufacturers, and been able to become the default browser if a computer manufacturer or consumer elected to use Netscape in that way. Other firms in the industry would have been free to collaborate with Netscape without fear of retaliation by Microsoft.

Most fundamentally, Mr. Barksdale apparently believes that Microsoft should be altogether prohibited from competing with start-up firms like his former company. The Courts found that Microsoft engaged in specific practices that were unlawful under the antitrust laws. The proposed Final Judgment prohibits those unlawful acts, contains specific prohibitions to prevent their recurrence, and takes affirmative steps to restore the competitive conditions in the middleware marketplace. Consumers benefit from competition. The goal of the antitrust laws, therefore, is to protect competition, not to favor start-up firms over incumbents.



## QUESTION

2. The remedy filed by the non-settling States would require that the agreement be enforced by a court-appointed special master with the authority to monitor Microsoft's complaints, and with the power to investigate, call witnesses, and conduct hearings if the company appears to have violated the agreement. Your proposed settlement provides for a three-member panel paid for by Microsoft that can listen to and investigate complaints, but which lacks the independent authority to convene hearings and examine witnesses. This panel must turn to the Justice Department for any such activity, and its members may not offer testimony themselves in any proceeding. Although the three member panel might be helpful in gathering some information, in terms of actual enforcement, the Justice Department will have to start from scratch with any action. In light of the fact that everyone agrees that this is a rapidly-moving industry, the inherent delays in such a process seem more likely to hamper than to enhance Microsoft's compliance with the decree. Why did you decide to create this unique and limited panel, rather than a more traditional special master?

## ANSWER

The Department believes that this and other Department antitrust final judgments can and should be enforced by the Department. Contrary to the assumption underlying this question, there is no history or tradition of the Department delegating enforcement responsibility for its antitrust enforcement orders to third parties. Moreover, the Department believes that delegating enforcement authority to a special master in this particular case would have been misguided, possibly resulting in that individual becoming a one-person regulatory body, exercising de facto regulatory control over a broad range of behavior and conduct in the information technology sector, and setting antitrust enforcement policy in the process.

The proposed Final Judgment ensures that the full force of the United States is available to enforce the judgment. The three-person compliance team was never intended to displace that enforcement authority. Rather, it is intended to facilitate enforcement through regular access to information and an affirmative obligation to report violations to the Department. Should the Department seek an enforcement action against Microsoft, it will not have to "start from scratch." The Department is not precluded from utilizing, relying on, or making derivative use of, the technical committee's work product, findings or recommendations in connection with any activities relating to enforcement of the proposed Final Judgment.

Assuming that a special master would be required to afford individuals appropriate procedural protections and that its determinations would be subject to judicial review, the Department does not see any basis for assuming that enforcement by a special master would be more expeditious than enforcement by the Department. In fact, the Department believes that the very opposite would be true.

## QUESTION

3. The Court of Appeals specifically held - twice - that commingling the browser and operating system code violated section 2 of the Sherman Act. Yet, the proposed settlement contains no prohibition on commingling code. In your testimony before the Committee, you explained that the Department had never taken the position that Microsoft should be required to remove code from the operating system, and that the proposed settlement is thus consistent with a long-standing position of the Department. That explanation appears to neglect two things: First, the settlement is forward-looking, and second, the court's determination that commingling code was an exclusionary act. Taken together, these facts suggest that a ban on future exclusionary commingling of code is entirely consistent with the Department's position, would provide appropriate relief for the violation found, and would help prevent its recurrence. Do you agree that such a ban on future exclusionary commingling would comport with the Court of Appeals decision? Did you consider such a ban? Do you agree that such a ban on future exclusionary commingling would provide appropriate relief for the violation found, and would help prevent its recurrence?

## ANSWER

The Department challenged Microsoft's practice of commingling operating system and browser code for the purpose of preventing the removal of its browser. The proposed Final Judgment fully addresses this conduct by requiring Microsoft to create and maintain an effective add/remove function for certain Microsoft middleware and to permit competing middleware to take on a "default" status that will override middleware functions Microsoft has integrated into the operating system. The provisions, therefore, will stop the offending conduct and prevent its recurrence.

Consistently throughout its discussion of the remedy in this case, the Department has maintained that it did not seek to require Microsoft to remove the commingled code. The Department does not read the Court of Appeals' decision to state an affirmative rule of software design prohibiting all future commingling divorced from any adverse effect on competition. As the Court of Appeals noted, it is the use of the middleware product by the consumer, not the presence of the code, that has competitive significance. A ban on commingling without regard to competitive significance would impose a wholly unnecessary and artificial constraint on software design that could have adverse implications for consumers. Additionally, changes to the operating system required to implement such a prohibition likely would have adverse effects upon third parties that have already designed software to the present operating system code. A prohibition on commingling in this particular case, therefore, would be harmful, not helpful.

## QUESTION

- 4      There has never been a Tunney Act proceeding after litigation through the court of appeals before. In the first Microsoft-Department of Justice Tunney Act proceeding in 1994, the court suggested that great deference should be given to the appellate court's findings. Do you believe that the Court of Appeals' decision provides useful input to the definition of "public interest" in this unique context?

## ANSWER

The Department strictly adhered to the mandates within the Court of Appeals' decision in fashioning the remedy contained within the proposed Final Judgment. Beyond the Department's position set forth in its submissions to the District Court in this matter, however, it would be inappropriate for the Department to comment on the appropriate scope of the Court's discretion because the Court's review of the proposed Final Judgment is pending under the Tunney Act.

## QUESTION

- 5.(a). As I mentioned at the Committee's hearing, in describing your settlement, Fortune magazine said "Even the loopholes have loopholes." The settlement limits the types of retaliation Microsoft may take against PC manufacturers that want to carry or promote non-Microsoft software. By implication the settlement appears to give a green light to other types of retaliation. You responded to my question about retaliation by saying that the settlement would permit collaboration generally approved in the antitrust case law. Please clarify the Department's position a little further.

Why does the settlement not ban all types of retaliation?

## ANSWER

The term "retaliation" can be subject to overbroad interpretation in many contexts, including an antitrust final judgment. Literally, the term could be read to mean the withholding of any benefit in response to an undesired action. In a commercial context, a firm might be said to have "retaliated" against a prospective customer or supplier through any adverse action whether or not their interaction has any competitive significance. For example, if Microsoft decided for valid business reasons that it no longer wanted to engage in a particular business transaction, it could be accused of retaliating. To give the term retaliation meaning in the context of this proposed Final Judgment, reference must be made to the offending conduct, *i.e.*, actions taken against firms seeking to develop, promote or distribute competing middleware.

To amplify upon my answer at the hearing, the proposed Final Judgment does not, and should not, prohibit Microsoft from engaging in all forms of collaborative conduct. Such a prohibition would be anticompetitive to the extent that some forms of collaboration Microsoft might engage in would help in the creation or distribution of new products for the benefit of consumers. The proposed Final Judgment prohibits Microsoft from withholding benefits from those who support competing middleware products, while permitting the company to grant benefits specifically in the context of bona fide collaborative ventures under well-established antitrust standards (which necessarily means "withholding" those same "benefits" from companies not engaged in the particular bona fide collaborative venture).

## QUESTION

- 5.(b) The settlement requires Microsoft to treat PC manufacturers the same in some respects but in other important respects Microsoft is allowed to treat PC manufacturers differently. What are the ways in which Microsoft can treat differently PC manufacturers that carry competing software compared to those that agree to carry Microsoft products exclusively?

## ANSWER

Neither the antitrust laws generally, nor the Court of Appeals' decision specifically, require that Microsoft, even as a monopolist, treat all third-parties equally. In fact, in many instances "unequal" treatment (*e.g.*, collaboration between two companies that does not include other firms) evidences legitimate competition. Thus, the Department carefully crafted the proposed Final Judgment to ensure that it addresses the conduct found unlawful by the Court of Appeals without precluding conduct with potentially procompetitive effects.

Section III.A. contains a broad ban on retaliation by Microsoft against computer manufacturers because they support competing middleware or operating system products. Microsoft is, however, permitted to provide consideration to a computer manufacturer for a particular Microsoft product or service where such consideration is commensurate with the level or amount of the computer manufacturer's development, distribution, promotion or licensing of that specific product or service. Thus, Microsoft can base such consideration only on the absolute level or amount of the computer manufacturer's support for the Microsoft product or service, rather than any relative level or amount that may serve to exclude rivals' products. Section III.G.1. prohibits Microsoft from granting computer manufacturers and certain others consideration on the condition that they distribute, promote, use, or support exclusively or in a fixed percentage any Microsoft middleware or operating system. However, Microsoft is permitted to use fixed percentage arrangements where it is commercially practicable for the computer manufacturer or other entity to provide equal or greater support for software that competes with Microsoft's middleware or operating system. In addition, Microsoft may enter into bona fide joint ventures or joint development or joint services arrangements with computer manufacturers and others for a new product, technology or service, in which both Microsoft and the computer manufacturer or other entity contribute significant developer or other resources, that prohibits such entity from competing with the object of the joint venture or other arrangement for a reasonable period of time.

## QUESTION

- 5.(c). You referred at the hearing to the fact that the settlement would permit certain collaborative conduct between Microsoft and others. Please explain in detail what types of collaboration are permitted by the decree, and what types are forbidden.

## ANSWER

It would be inappropriate for the Department to comment on the ability of Microsoft to engage in specific, hypothetical collaborations. More generally, however, in addition to the forms of collaboration described in response to question 5.(b). above, Section III.F. of the proposed Final Judgment prohibits Microsoft from entering into agreements with software vendors that condition the grant of any consideration on the vendor refraining from developing, using, distributing, or promoting a software that competes with Microsoft's middleware or operating system or any software that runs on any software that competes with Microsoft's middleware or operating system. However, Microsoft may enter into agreements that place limitations on a software vendor's development, use, distribution, or promotion of any such software if those limitations are reasonably necessary to, and of reasonable scope and duration in relation to, a bona fide contractual obligation of the vendor to use, distribute, or promote any Microsoft software or to develop software for, or in conjunction with, Microsoft.

## QUESTION

- 5.(d). Among the exceptions in the proposed settlement to the bans on retaliation, Microsoft is permitted to provide "consideration to any OEM with respect to any Microsoft product or service where that consideration is commensurate with the absolute level or amount of that OEM's development, distribution, promotion, or licensing of that Microsoft product or service." This seems to permit Microsoft to reward OEMs based on whether they carry Microsoft's products or software; this is just the flip side of "retaliation." How is this different from punishing those who fail to accede to Microsoft's demands?

## ANSWER

Nothing in the antitrust laws generally or the Court of Appeals' decision specifically requires that Microsoft be prohibited from competing in the market by working with computer manufacturers to promote its products and services. Indeed, it is hard to imagine how any such prohibition would benefit consumers. Instead, the proposed Final Judgment addresses that conduct found unlawful by the Court of Appeals and permits conduct that has potentially procompetitive effects. Allowing Microsoft to provide consideration based on a relative level or amount of support may serve to exclude rivals' middleware products and, thus, is prohibited under the proposed Final Judgment. Whereas, allowing consideration based on the absolute level or amount of the computer manufacturer's support permits bona fide collaborations that may benefit consumers and are unlikely to exclude rivals. Thus, the proposed Final Judgment does not prohibit this conduct.

## QUESTION

6. In 1995, the Department and Microsoft entered into a Consent Decree. Two years later the Department sued Microsoft for contempt of the Decree when Microsoft and the Department disagreed over the meaning and correct interpretation of certain provisions of the Decree, including the meaning of the word "integrate" as that term was used in the Decree. Given the prior litigation between the Department and Microsoft over the proper interpretation of the 1995 Consent Decree, do you agree that Microsoft and the Department should have a common, explicit understanding of the meaning and scope of this Final Judgment before it is entered?

## ANSWER

The Department's goal was to reach as clear a settlement agreement as possible in this case. The proposed Final Judgment embodies the common, explicit understanding as to the settlement terms among the Department, the settling States and Microsoft.



## QUESTION

7. Do you agree that the meaning and scope of the proposed Final Judgment as agreed upon by the Department and Microsoft should be precise, unambiguous and fully articulated so that the public at large can understand and rely on your mutual understanding of the Judgment?

## ANSWER

The Department's goal is to make final judgments as precise and unambiguous as possible. The mutual understanding among the Department, the settling States and Microsoft in this case is embodied in the proposed Final Judgment.

## QUESTION

8. If Microsoft were to disagree with the Department's interpretation of one or more important provisions of the proposed Final Judgment, would you consider that to be a potentially serious problem?

## ANSWER

Whether or not Microsoft's interpretation of one or more provisions of the proposed Final Judgment would be a serious problem would depend on the specific nature of the disagreement and the provisions of the Final Judgment that were implicated, among other things. It would be inappropriate for the Department to speculate on the seriousness of a hypothetical disagreement.

## QUESTION

9. Do you agree that it would be highly desirable to identify any significant disagreement between Microsoft and the Department over the correct interpretation of the proposed Final Judgment now, before the Judgment is entered by the Court, rather than through protracted litigation as in the case of the 1995 Consent Decree?

## ANSWER

The proposed Final Judgment embodies the complete agreement between the Department and Microsoft. The proposed Final Judgment in this case was entered through the standard procedures under which the Department settles antitrust cases. It is hard to imagine a mechanism under which understandings reached outside of those procedures would be enforceable.

## QUESTION

10. Does the Competitive Impact Statement set forth the Department's definitive interpretation of its proposed Final Judgment with Microsoft?

## ANSWER

The Tunney Act establishes the requirements for a Competitive Impact Statement. Pursuant to the Act, 15 U.S.C. § 16, a Competitive Impact Statement provides:

- (1) the nature and purpose of the proceeding;
- (2) a description of the practices or events giving rise to the alleged violation of the antitrust laws;
- (3) an explanation of the proposal for a consent judgment, including an explanation of any unusual circumstances giving rise to such proposal or any provision contained therein, relief to be obtained thereby, and the anticipated effects on competition of such relief;
- (4) the remedies available to potential private plaintiffs damaged by the alleged violation in the event that such proposal for the consent judgment is entered in such proceeding;
- (5) a description of the procedures available for modification of such proposal; and
- (6) a description and evaluation of alternatives to such proposal actually considered by the United States.

## QUESTION

11. Has Microsoft informed the Department that it has any disagreement with the Department's interpretation of the Final Judgment as set forth in the Competitive Impact Statement?

## ANSWER

The Department is unaware of any disagreement that Microsoft may have with the Competitive Impact Statement.

## QUESTION

12. Can the public at large rely upon the Department's Competitive Impact Statement as the definitive interpretation of the nature and scope of Microsoft's obligations under the Final Judgment?

## ANSWER

As explained in response to Question 10 above, the Tunney Act establishes the requirements for a Competitive Impact Statement. Pursuant to the Act, 15 U.S.C. § 16, the Competitive Impact Statement provides the public and others with:

- (1) the nature and purpose of the proceeding;
- (2) a description of the practices or events giving rise to the alleged violation of the antitrust laws;
- (3) an explanation of the proposal for a consent judgment, including an explanation of any unusual circumstances giving rise to such proposal or any provision contained therein, relief to be obtained thereby, and the anticipated effects on competition of such relief;
- (4) the remedies available to potential private plaintiffs damaged by the alleged violation in the event that such proposal for the consent judgment is entered in such proceeding;
- (5) a description of the procedures available for modification of such proposal; and
- (6) a description and evaluation of alternatives to such proposal actually considered by the United States.

## QUESTION

13. If the public cannot rely on the Department's interpretation of the proposed Final Judgment as set forth in the Competitive Impact Statement, then what is the mutually understood and agreed-upon interpretation of the meaning and scope of Microsoft's obligations under the Final Judgment?

## ANSWER

The proposed Final Judgment itself embodies the mutually understood and agreed-upon settlement agreement among the Department, the settling States and Microsoft.

## QUESTION

14. The Tunney Act requires that Microsoft file with the district court “any and all written or oral communications by or on behalf of [Microsoft]...with any officer or employee of the United States concerning or relevant to such proposal, except that any such communications made by counsel of record alone with the Attorney General or the employees of the Department of Justice alone shall be excluded from the requirements of this subsection.” Microsoft has recently made its filing, and many have been surprised by its brevity. Do you believe that this provision requires disclosure of communications by Charles Rule to the Justice Department prior to the date upon which he became counsel of record? Do you believe it requires disclosure of contacts made on behalf of Microsoft to members of Congress? How does the Department define “concerning or relevant to” the proposed settlement? Is that definition consistent across all Tunney Act proceedings? Do you believe that it covers anything more than the actual negotiations of the decree?

## ANSWER

Pursuant to 15 U.S.C. § 16(g), defendants must file a description of specified communications relating to the proposed settlement. These filings are made to the district court and are not evaluated or reviewed by the Department. It would inappropriate in this case for the Department to comment on Microsoft's § 16(g) filing or interpret the requirements of the Tunney Act as they relate to its obligations.



## SENATOR HATCH'S QUESTIONS

### QUESTION

1. One of the principal concerns voiced by critics of the Proposed Settlement is that it lacks an effective enforcement mechanism. These critics suggest that some type of fast-track enforcement mechanism, such as the appointment of a special master, is necessary to ensure compliance. Could you please explain: First, why you believe the enforcement avenues provided for by the Proposed Settlement are sufficient; and, Second, how you envision effective enforcement actually being carried out in the real world?

### ANSWER

The proposed Final Judgment contains one of the most stringent regimes of compliance ever contained in a final judgment entered by the Department. The proposed Final Judgment provides, as it should, for direct enforcement by the Department, supplemented by full-time, on-site monitoring by an expert compliance team, and a further penalty in the event of recurring violations. The Department believes that it has the resources, expertise, and, most importantly, the expert knowledge of the antitrust laws and the public interest focus to fully enforce the Final Judgment. Further, the Department sees no basis for the assertion that enforcement by a special master would be any more efficient, expeditious or effective than enforcement by the Department.

A core team of experienced lawyers and economists established within our newly formed Networks & Technology Section, and including members of the litigation team, is charged with enforcement of the proposed Final Judgment. This enforcement team, assisted by the technical committee formed under the proposed Final Judgment, will monitor Microsoft's compliance with the Final Judgment and take any necessary action, up to and including initiating contempt proceedings, to ensure effective enforcement.

## QUESTION

- 2 Because the three-person Technical Counsel created by the Proposed Settlement has no enforcement powers, won't the level of enforcement of the Proposed Settlement depend principally on how proactive the Department and State Attorneys General are in dedicating resources and attention to prompt and effective oversight and enforcement? What resources does the Department plan on committing to enforcement of the Proposed Settlement?

## ANSWER

The Department believes that it should enforce the remedial orders entered in the cases it has prosecuted. We further believe that the Court is the appropriate forum in which to air disputes concerning enforcement of the Court's order. The Department does not delegate its enforcement responsibilities in antitrust matters to third parties. We, therefore, specifically rejected the notion of granting enforcement authority to the technical committee that would have supplanted the enforcement power of the United States

The proposed Final Judgment will be enforced by the skilled men and women of the Department's Antitrust Division. We are very proud of the work performed by the Division staff on this case, who worked tirelessly to secure the liability determinations upon which the proposed Final Judgment is premised. We, therefore, adamantly reject any assertion that the staff is not up to the task of enforcing this proposed Final Judgment. A core team of experienced lawyers and economists established within our newly formed Networks & Technology Section, and including members of the litigation team, is charged with enforcement of the proposed Final Judgment. This enforcement team, assisted by the technical committee formed under the proposed Final Judgment, will monitor Microsoft's compliance with the Final Judgment and take any necessary action, up to and including initiating contempt proceedings, to ensure effective enforcement.

## QUESTION

3. In my opening statement, I raised the issue of prompt and effective enforcement in high-technology markets. As the D.C. Circuit clearly recognized, the passage of time frequently overtakes alleged anticompetitive actions, making them - in the D.C. Circuit's language - "obsolete" before a remedy is devised and implemented. In your view, what can be done to minimize this problem and ensure that antitrust remedies are developed early enough to provide meaningful relief?

## ANSWER

The Department believes that the current antitrust laws are sufficient to guarantee not only competition, but timely enforcement in high-tech areas, such as the software industry.

## QUESTION

4. Could you explain the pros and cons of having the enforcement function performed by governmental agencies as opposed to a special master or adjudicatory panel of some type?

## ANSWER

The Department believes that it should enforce the remedial orders entered in the cases it has prosecuted. The Department does not delegate that function to third parties in antitrust matters and believes that departing from that well-established policy would be particularly troublesome in this case. The Department has the necessary resources, expertise and enforcement authority to carry out this function, just as it has in countless other cases. Moreover, the Department has the expert knowledge of the antitrust laws and the public interest focus required for this task.

The proposed Final Judgment covers a broad range of competitive interaction between Microsoft and firms at every level of the information technology industry. As is evident already, many in the industry see Microsoft's liability as a basis for demanding all manner of private rights, whether or not their demands have anything to do with the matters litigated in the case. Delegating actual enforcement power to any third party in this case would have been misguided, possibly resulting in that individual becoming a de facto regulatory body, exercising broad control over the information technology sector, and doing so without the legal framework that ordinarily would be imposed upon such a scheme. The Microsoft case is a public law enforcement matter. The Department believes that enforcement of the proposed Final Judgment should rest with the public agency charged with that function. The Department also has complete confidence in the Court to act expeditiously and to enter orders enforcing the proposed Final Judgment as appropriate.

## QUESTION

5. Could you also explain why you oppose - assuming that you do oppose - an alternate or additional enforcement mechanism?

## ANSWER

The enforcement mechanism contained in the proposed Final Judgment will effectively ensure Microsoft's timely compliance with the judgment. An alternate or additional enforcement mechanism is unnecessary.

## QUESTION

6. As you know, I believe that one important aspect of the Internet is the freedom that consumers have to choose where to go and what websites to visit. Currently, consumers can choose to go to whatever websites they want. Commentators and industry participants argue that there is a legitimate fear that an Internet mediator might - for one reason or another - decide to limit access to certain sites while traffic is directed to other sites, or decide that certain sites will be treated differently than other sites in ways that push consumers in the direction of favored sites instead of leaving the choice entirely and fairly to consumers. Who do you believe should choose where a consumer can go online, the consumer or the Internet mediator, be it an Internet service provider, a software company, or a cable or satellite company? Also, could you please explain whether and why you believe this is an important competition policy concern?

## ANSWER

The mission of the Department is to enforce the federal antitrust laws. The Department would evaluate any conduct by firms in the computer industry, including Internet mediators, that harms consumers and may violate the antitrust laws. The Department does not, however, have a view in the abstract as to who should decide where a consumer can go online.

## QUESTION

7. Some critics claim that the only real penalty Microsoft faces for violating the Proposed Settlement is the extension of the terms of the Settlement for two additional years. Is that an accurate criticism; and, if not, could you please briefly explain the penalties faced by Microsoft if it fails to abide by the Proposed Settlement?

## ANSWER

The Department fundamentally disagrees with this criticism. In addition to seeking the penalty of extending the proposed Final Judgment term for an additional two years, the Department has all of the enforcement powers available to it under federal law, including criminal or civil contempt proceedings, petitions for injunctive relief to halt or prevent violations, motions for declaratory judgment to clarify or interpret particular provisions, and motions to modify the proposed Final Judgment.

## QUESTION

8. Could you please expand on why you believe the Department has sufficient expertise to accurately evaluate the competitive implications of software design and other technical development choices? Additionally, specifically what has the Department done to ensure that it has the expertise necessary to assess at an early stage both the lawfulness and potential anticompetitive effects of highly-technical actions taken by companies such as Microsoft? Does the Department have a specific plan for allocating resources or personnel to develop the necessary expertise to identify and take effective action while potential antitrust problems are still on the horizon?

## ANSWER

The Department has both the resources and capability to address such technical issues, as they affect enforcement matters, through internal means and, where appropriate, the retention of outside experts. The Department has staff attorneys and economists, including members of the staff that worked tirelessly on the Microsoft case for many years, who have significant technical expertise in the software industry, as well as other high-tech fields. The Department routinely investigates, and relies on the expertise of its personnel to assess the effects of, companies' conduct in these high-tech industries. The Department continuously evaluates and seeks to improve its expertise to allow it to identify and take effective action to address competitive issues.



## QUESTION

9. In his written testimony (pp. 18-19), Mr. Himes of the New York State Attorney General's Office briefly discusses the importance of the Proposed Settlement's definition of "Middleware." The D.C. Circuit defined middleware very simply as "software products that expose their own APIs [or 'Application Programming Interfaces']". *Microsoft*, 253 F.3d at 53. Could you explain why the Proposed Settlement adopts a narrower, two prong definition? Could you also further explain the distribution threshold contained in the definition of "Non-Microsoft Middleware Products," requiring that - to meet the definition - at least one million copies of the Middleware Product have been distributed within the United States during the previous year? Will this threshold provision disadvantage innovation among start-up entrepreneurs or those who develop software for highly-specialized markets as some have criticized? Is there some other way to address the concerns underlying this "one million copy" threshold?

## ANSWER

The Court of Appeals' decision did not seek to define the term middleware in a manner that would suffice for remedial purposes. Rather, the opinion contains descriptive language to aid in the exposition of the issues in the case. For remedial purposes, the definition must be more technical so as to ensure limits within the terms of the liability found and enforceability of the proposed Final Judgment. The Court of Appeals found that Microsoft engaged in anticompetitive practices with respect to two middleware products, Web browsers and Java. Those products were deemed to have exposed a range of APIs so as to have the potential to evolve into an alternate platform, thereby threatening Microsoft's operating system monopoly. Not all products that expose APIs have that quality. The proposed Final Judgment adopts a broad definition of middleware that includes the specific products at issue in this case, other specific products that already have emerged as potential alternative platforms, and products that may be developed in the future that may have similar cross-platform qualities.

Under the proposed Final Judgment, a computer manufacturer will have the right to install any competing middleware application, without regard to the number of copies of that competing middleware that have been distributed. The one million copy limitation exists only with respect to the requirements that Microsoft make public the APIs used in its own middleware products and redesign the operating system to provide a competing middleware product "default" status — *i.e.*, the ability to override automatically Microsoft middleware functions integrated into the operating system. The limitation strikes the proper balance between the substantial costs associated with such documentation and redesign efforts, and the competitive potential of products with fewer than one million copies distributed. To do otherwise would have put the operating system in a state of constant flux, which would have had disastrous implications for users and developers alike. Moreover, in a world of about 625 million PC users and software distribution via downloads and direct mail, distribution of only one million copies, rather than sales, installation or usage, is a relatively minor threshold in the software industry today. As you

know, Americans routinely receive unsolicited software offers via the mail every day.

## QUESTION

10. I found Mr. Jim Barksdale's letter noteworthy in several respects, but am particularly interested in his claim that the Proposed Settlement would not have prevented Microsoft's unlawful actions against Netscape. Could you please discuss whether the Proposed Settlement would have prevented the actions taken by Microsoft against Netscape that the D.C. Circuit held to be unlawful had the Proposed Settlement been in existence in 1995, and, if so, how?

## ANSWER

Mr. Barksdale makes the curious assertion that Netscape would have fared better without the proposed Final Judgment than with it. The proposed Final Judgment expressly prohibits the very practices Microsoft deployed to impede the emergence of Netscape's Navigator and found unlawful by the Court of Appeals. Thus, had the Final Judgment been in effect, Netscape would have had access to Microsoft's APIs in the development process, been able to obtain distribution through computer manufacturers, and been able to become the default browser if a computer manufacturer or consumer elected to use Netscape in that way. Other firms in the industry would have been free to collaborate with Netscape without fear of retaliation by Microsoft.

## SENATOR DEWINE'S QUESTIONS

### QUESTION

1. The term of the proposed settlement is only five years, while many other antitrust consent decrees last for ten years. The Department has suggested that a shorter time period is justified because this industry changes rapidly and a longer decree may not be warranted after five years. Given that the Department of Justice has the ability to go to the court and seek to modify a consent decree or terminate it if market conditions warrant such a change, why not impose a longer period of enforcement, and then decide later if it needs to be modified or abandoned?

### ANSWER

The mission of the Department is to enforce the federal antitrust laws and remedy specific violations thereof. This mission does not include regulating competition. Entering into an open-ended final judgment with the intent of reevaluating its terms on a going-forward basis would be contrary to the Department's mission.

## QUESTION

- 2 As the Court of Appeals in this case noted, the Supreme Court has indicated that a remedies decree in an antitrust case must seek to “unfetter a market from anticompetitive conduct,” “terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future.” Do you believe that this is the appropriate standard to use? If so, do you believe the proposed final judgment denies Microsoft the fruits of its illegal acts? Specifically, can you discuss whether Microsoft has been denied the fruits of its effort to maintain a monopoly in the operating system?

## ANSWER

In agreeing to the proposed Final Judgment, the Department followed the Court of Appeals’ decision in this case and applicable precedent. The Court of Appeals determined that Microsoft had illegally maintained its operating system monopoly by engaging in specific anticompetitive practices. While some have argued that the “fruits” of this violation are the continued monopoly in the operating system market and/or a monopoly in the Web browser market, that is inconsistent with the Court of Appeals’ decision. In discussing the scope of an appropriate remedy, the Court of Appeals noted, “the District Court expressly did not adopt the position that Microsoft would have lost its position in the OS market but for its anticompetitive behavior.” *U.S. v. Microsoft*, 253 F.3d 34, 107 (D.C. Cir. 2001). Further, the Court reversed the District Court’s findings that Microsoft had attempted to monopolize the Web browser market and engaged in illegal tying. Consequently, there was no mandate for the Department to strip Microsoft of its market position in either the operating system or Web browser markets.

The proposed Final Judgment denies Microsoft the ability to use its operating system monopoly to exclude competing middleware products. In addition to prohibiting the illegal practices, Microsoft is now required to provide to actual and potential competitors APIs never before disclosed to them. Microsoft also must make design changes that permit competing middleware to substitute as the default product. Finally, Microsoft must now disclose to competitors communications protocols for servers. These proactive provisions create a far more positive environment for the development of competing middleware than existed at the time of Microsoft’s unlawful behavior. In this environment, software developers will have a full opportunity to compete for consumer patronage that might make them an actual threat to Microsoft’s operating system monopoly.

## QUESTION

3. The proposed settlement has some prohibitions against Microsoft retaliating against computer manufacturers that place competing software on their computers-these provisions are intended to allow manufacturers to offer non-Microsoft products if they choose. I understand that Microsoft currently offers incentives to computer manufacturers if they can get computers to "boot up" quickly. Some believe that computer manufacturers will not want to slow down the start-up time by placing additional software on the computer because they will risk losing the incentive payment. Does the proposed settlement deal with this problem?

## ANSWER

The Court of Appeals decision in this case did not specifically address the speed at which computers "boot up." Nor does the proposed Final Judgment. However, the proposed Final Judgment does prohibit Microsoft from using market development allowances or other discounts if they are inconsistent with any other provision in the proposed Final Judgment. This would include, for example, retaliation against computer manufacturers for using non-Microsoft middleware implemented through incentive payments for faster "boot ups."

## QUESTION

4. The Appellate Court noted that the applications barrier protects Microsoft's operating system monopoly. The Court stated that this allows Microsoft the ability to maintain its monopoly even in the face of competition from potentially "superior" new rivals. In what manner do you believe the proposed settlement addresses the applications barrier?

## ANSWER

The proposed Final Judgment addresses the applications barrier by restoring the nascent competitive threat to Microsoft's operating system posed by middleware products. Middleware products expose their own APIs, and thus, allow software developers to write programs that run on the middleware itself. An application written to rely exclusively on a middleware program's interfaces could run on all operating systems on which that middleware runs. Because such middleware also runs on Windows, applications developers would not be required to sacrifice Windows compatibility if they choose to write applications for a middleware platform. Applications developers would thus have incentives to write for widely used middleware, and users would not be reluctant to choose a non-Windows operating system for fear that it would run an insufficient array of applications.

In addition to prohibiting the illegal practices, Microsoft is now required to provide to actual and potential competitors APIs never before disclosed to them. Microsoft also must make design changes that permit competing middleware to substitute as the default product. Finally, Microsoft must now disclose to competitors communications protocols for servers. These proactive provisions create a far more positive environment for the development of competing middleware than existed at the time of Microsoft's unlawful behavior. In this environment, software developers will have a full opportunity to compete for consumer patronage that might make them an actual threat to Microsoft's operating system monopoly.

## QUESTION

5. Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don't want them. This potentially deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, it seems that software developers are more likely to write their programs to operate on Microsoft's middleware if they know that the Microsoft middleware will always be on the computer whereas competing products may not be. Even if consumers are unaware that code is commingled, should we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code?

## ANSWER

The Court of Appeals concluded that Microsoft unlawfully commingled its operating system and browser code for the purpose of preventing the removal of its browser. The Court found that this had the effect of deterring competition not because of the presence of the Microsoft middleware code, but because of the use of the middleware by consumers. The proposed Final Judgment fully addresses the conduct found unlawful by requiring Microsoft to create and maintain an effective add/remove function for all Microsoft middleware and to permit competing middleware to take on a "default" status that will override middleware functions Microsoft has integrated into the operating system.

A ban on commingling without regard to competitive significance would impose a wholly unnecessary and artificial constraint on software design that could have adverse implications for consumers. Additionally, changes to the operating system required to implement such a prohibition likely would have adverse effects upon third parties that have already designed software to the present operating system code. A prohibition on commingling in this particular case, therefore, would be harmful, not helpful.



## QUESTION

6. Many believe that this settlement proposal merely requires Microsoft to stop engaging in illegal conduct, but does little in the way of denying Microsoft the benefits of its bad acts. First, how would you answer these critics? Is this just a built-in reality of civil antitrust remedies, i.e., that they don't aim to punish? And second, do you believe the remedy here is strong enough to dissuade other potential monopolists from engaging in the type of conduct in which Microsoft engaged?

## ANSWER

It is true that by statute and applicable Supreme Court precedent, there is no legal basis for "punishing" a civil defendant in a civil antitrust decree. Thus, for example, the Department cannot impose a civil fine. In agreeing to the proposed Final Judgment, the Department followed the Court of Appeals' decision in this case and applicable precedent. The Court of Appeals determined that Microsoft had illegally maintained its operating system monopoly by engaging in a series of specific anticompetitive practices. While some have argued that the "fruits" of this violation are the continued monopoly in the operating system market and/or a monopoly in the Web browser market, that is inconsistent with the Court of Appeals' decision. In discussing the scope of an appropriate remedy, the Court of Appeals noted, "the District Court expressly did not adopt the position that Microsoft would have lost its position in the OS market but for its anticompetitive behavior." *U.S. v. Microsoft*, 253 F.3d 34, 107 (D.C. Cir. 2001). Further, the Court reversed the District Court's findings that Microsoft had attempted to monopolize the Web browser market and engaged in illegal tying. Consequently, there was no mandate for the Department to strip Microsoft of its market position in either the operating system or Web browser markets. The proposed Final Judgment does, however, stop the unlawful conduct found by the Court of Appeals, prevent its recurrence and restore the competitive conditions in the middleware market.

The Department believes that the proposed remedy in this case is strong enough to deter others firms who may engage in the type of unlawful conduct in which Microsoft engaged.

## QUESTION

7. Nine states didn't join with the Department of Justice's proposed final judgment because they didn't believe it adequately addressed competitive problems. These states recently filed their own remedy proposals. These states assert that one fruit of Microsoft's illegal conduct is Microsoft's dominant share of the Internet browser market. They propose to deny Microsoft this benefit of its violations by requiring it to open-source the code for Internet Explorer. What do you believe the competitive impact of such action would be?

## ANSWER

The credibility of the antitrust enforcement process requires the Department to respect the Court's rulings in this case, including those that were adverse. The Department was unsuccessful with regard to some of its claims. It would be inappropriate for the Department to seek remedies designed to redress claims upon which it was unsuccessful under the guise of claims actually sustained by the Court.

The sole basis for liability sustained by the Court of Appeals was monopoly maintenance. The monopoly maintenance claim asserted that Microsoft impeded a "nascent" threat to its operating system monopoly. The Department conceded, and the courts found, that any actual effect of that conduct on competition in the operating system market would have occurred well off into the future, if at all. The courts rejected both the exclusive dealing and attempted monopolization counts, and reversed the finding of unlawful tying. In fact, the Court of Appeals found that the Plaintiffs failed to prove that Web browsers were even a distinct market. Those were the only government claims asserting anticompetitive impact or unlawful gain to Microsoft in the market for Web browsers. Thus, within the confines of this case, there is no legal basis for asserting that Microsoft's present share in browsers is a "fruit" of its unlawful conduct, and a remedy requiring disclosure of the source code for Microsoft's browser, therefore, would be an unfounded expropriation of Microsoft's intellectual property.

It is not a goal of public antitrust enforcement to restructure competitive relationships or to secure competitive benefits for private firms, divorced from a finding of unlawful behavior. Such action by the Department would be a distortion of the antitrust enforcement process that would undermine the very goals of the antitrust laws.

## QUESTION

8. Given Microsoft's monopoly power in the operating system, some believe that merely allowing computer manufacturers to place competing software and icons on the operating system will not impede Microsoft's ability to capture a dominant share of any product that it binds to its operating system. Do you believe that media players, instant messaging services, and other competing products will be able to compete with similar MS products that are bound to the operating system?

## ANSWER

There are, today, media players and instant messaging services that compete with similar Microsoft products. The proposed Final Judgment ensures that competing middleware products, such as media players and instant messaging software, will have the opportunity to compete with Microsoft's products. Specifically, the proposed Final Judgment prohibits Microsoft from impeding consumer choice of competing middleware products by requiring Microsoft to create and maintain a mechanism for consumers and computer manufacturers to replace Microsoft's middleware. In this way, the proposed Final Judgment preserves and reinforces the notion of consumer choice. It permits consumers to choose between Microsoft and non-Microsoft middleware and to configure their desktops accordingly.

The proposed Final Judgment provides the opportunity for middleware products to compete on the competitive merits. If developers of competing middleware products can generate consumer patronage by offering superior products at attractive prices, consumers (and/or the OEMs they purchase from) will select their products over those offered by Microsoft. Consistent with the goals of the antitrust laws, however, the proposed Final Judgment provides the opportunity for the competitive process to determine how well competing middleware producers fare in the marketplace.

## QUESTION

9. Many have criticized the proposed final judgment saying it has loopholes in it that will allow Microsoft to continue operating as it has done in the past. For example, the proposed final judgment clearly seeks to prevent Microsoft from retaliating against computer manufacturers that install competing software onto the computer. However, because the provisions are limited to specific practices or types of software, and apply only to "agreements" between Microsoft and computer manufacturers, many believe that Microsoft will find alternative methods of controlling the practices of computer manufacturers. Do you believe competition would be better served if Microsoft were broadly prohibited from retaliating against computer manufacturers?

## ANSWER

The term "retaliation" can be subject to overbroad interpretation in many contexts, including an antitrust final judgment. Literally, the term could be read to mean the withholding of any benefit in response to an undesired action. In a commercial context, a firm might be said to have "retaliated" against a prospective customer or supplier through any adverse action whether or not their interaction has any competitive significance. For example, if Microsoft decided for valid business reasons that it no longer wanted to engage in a particular business transaction, it could be accused of retaliating. To give the term retaliation meaning in the context of this proposed Final Judgment, reference must be made to the offending conduct, *i.e.*, actions taken against firms seeking to develop, promote or distribute competing middleware.

To amplify upon my answer at the hearing, the proposed Final Judgment does not, and should not, prohibit Microsoft from engaging in all forms of collaborative conduct. Such a prohibition would be anticompetitive to the extent that some forms of collaboration Microsoft might engage in would help in the creation or distribution of new products for the benefit of consumers. The proposed Final Judgment prohibits Microsoft from withholding benefits from those who support competing middleware products, while permitting the company to grant benefits specifically in the context of bona fide collaborative ventures under well-established antitrust standards (which necessarily means "withholding" those same "benefits" from companies not engaged in the particular bona fide collaborative venture).

## QUESTION

10. The Court of Appeals ruled that Microsoft's practices which undermined the competitive threat of Sun's Java technology was an antitrust violation. The remedy proposed by the states that do not support the DOJ's proposed settlement would require Microsoft to distribute Java with its browser as a means of restoring Java's position in the market. Do you believe this would be beneficial to competition? What does the DOJ's proposed settlement do to restore this competition?

## ANSWER

As a public antitrust enforcement mechanism, the proposed Final Judgment does not seek to confer specific strategic or financial benefits upon specific companies. Indeed, the antitrust laws specifically leave it to private parties to secure that form of relief in private antitrust actions they file on their own behalf, and many companies have availed themselves of that opportunity. The proposed Final Judgment, however, addresses, with respect to all middleware producers, including Sun Microsystems' Java, the conduct that the Court of Appeals found to have impeded the development and distribution of Java. Having eliminated the unlawful practices, the proposed Final Judgment will allow Sun to compete for consumer patronage against any similar technology Microsoft might elect to offer. It would be inappropriate for the Department to dictate through government mandate consumer choice of a particular middleware product. Consumer choice, not government decree, should determine the market result. Requiring Microsoft to distribute Java with every Microsoft browser would not restore competition to its previous form; rather, it would give Java a competitive advantage over other firms' products.

## QUESTION

11. Definition U. of the Proposed Final Judgment appears to allow Microsoft to determine in its sole discretion what constitutes the operating system. The Court of Appeals left open the possibility of a tying case against Microsoft. Will this provision essentially foreclose any opportunity of bringing a tying claim against Microsoft? Why do you give Microsoft the ability to make this determination?

## ANSWER

Definition U. in the proposed Final Judgment will not foreclose any opportunity of bringing a tying claim against Microsoft. The definition applies only to the duties and obligations imposed on Microsoft by the proposed Final Judgment. Although the proposed Final Judgment does not prohibit Microsoft from tying its products, it does not grant Microsoft any new rights under the antitrust laws with respect to product integration.

The Department agreed to include this clause in Definition U. because it merely confirms what Microsoft already had the power to do -- label its own operating system products. This clause does not negatively impact the operative provisions of the proposed Final Judgment because they principally rely on other definitions, such as Microsoft Middleware Product, regardless of how Microsoft labels its operating system. Moreover, the clause does not affect whether software that Microsoft chooses to label as part of the package it calls its "Windows Operating System Product" is or is not a separate "product" for antitrust purposes.

## QUESTION

12. Many antitrust cases involve the appointment of a special master who has some level of enforcement authority. This proposed final judgment does not do that and instead relies primarily upon standard civil and criminal contempt proceedings, as well as a special three person panel. Why has the Division elected not to appoint a special master that may speed effective enforcement, especially given the Division's concern for how rapidly this market changes?

## ANSWER

Contrary to the premise of the question, there is no history or tradition of the Department delegating enforcement responsibility for its antitrust enforcement orders to special masters. The Department is the public agency entrusted to carry out that function and has the resources, expertise and public interest focus necessary to accomplish the task. Moreover, the Department disagrees fundamentally with the notion that enforcement of the proposed Final Judgment by a special master would be more efficient or expeditious in this case. Assuming that the resolution of disputes by a special master would involve reasonable procedural protections for all concerned, including a right of judicial appeal, there is no reason to believe that the special master process would be any less litigious or time-consuming than enforcement by the Department in this case, and may in fact introduce even more delay into the enforcement process.

## QUESTION

13. The Department of Justice has indicated that one motivation for entering into this settlement was to provide immediate relief and avoid lengthy court proceedings. At the same time, many of the provisions of the settlement don't become active for up to 12 months after the settlement is enacted. Given your belief that relief should be immediate, why wait so long for these provisions to become active?

## ANSWER

The only provisions in the proposed Final Judgment that do not require Microsoft to immediately abide by their terms once the Final Judgment is in effect are Sections III.D., III.E., and III.H. These provisions provide Microsoft with a limited amount of time to implement the company's affirmative obligations because they require Microsoft to actually redesign its products or establish new disclosure procedures that will take time to accomplish. In addition, requiring Microsoft to immediately disclose the unfinished interfaces for its new products in development in Section III.D. would actually be detrimental to the market because Microsoft continuously changes and improves these interfaces before a product is finalized. If a software developer uses interfaces disclosed to it in its products and the interfaces are subsequently modified, this may disable both the software product and the operating system. Giving Microsoft a limited amount of time to implement its duties under these provisions ensures that they are properly implemented.



## QUESTION

14. One provision of the proposed final judgment requires Microsoft to allow consumers or computer manufacturers to enable access to competing products. However, it appears that III.H. of the Stipulation and VI.N. indicate that for a product to qualify for these protections it must have had a million copies distributed in the United States within the previous year. This seems to run contrary to the traditional antitrust philosophy of promoting new competition. Is this in fact the case? And if so, why are these protections limited to larger competitors?

## ANSWER

Under the proposed Final Judgment, a computer manufacturer will have the right to install any competing middleware application, without regard to the number of copies of that competing middleware that have been distributed. The one million copy limitation exists only with respect to the requirements that Microsoft make public the APIs used in its own middleware products and redesign the operating system to provide a competing middleware product "default" status — *i.e.*, the ability to override automatically Microsoft middleware functions integrated into the operating system. This limitation strikes the proper balance between the substantial costs associated with such documentation and redesign efforts, and the competitive potential of products with fewer than one million copies distributed. To do otherwise would have put the operating system in a state of constant flux, which would have had disastrous implications for users and developers alike. Moreover, in a world of about 625 million PC users and software distribution via downloads and direct mail, distribution of only one million copies, rather than sales, installation or usage, is a relatively minor threshold in the software industry today. As you know, Americans routinely receive unsolicited software offers via the mail every day.

## SENATOR MCCONNELL'S QUESTIONS

### QUESTION

1. Can you describe how the appeals court ruling impacted the case originally brought by the Department of Justice in 1998?

### ANSWER

Not only the Court of Appeals' ruling, but also the trial court's earlier determinations disposing of alternative theories of antitrust liability advanced by the Department of Justice and the State plaintiffs, significantly impacted the Microsoft case.

The federal government's complaint alleged four specific antitrust violations: (1) attempted monopolization of the browser market in violation of Section 2 of the Sherman Act; (2) specific anticompetitive acts, and a course of conduct, to maintain the operating system monopoly, also in violation of Section 2; (3) unlawfully tying the Web browser to the operating system in violation of Section 1; and (4) exclusive dealing in violation of Section 1. Additionally, the State plaintiffs alleged that Microsoft employed unlawful monopoly leveraging tactics to move into the browser market in violation of Section 2 and monopolization with respect to Microsoft Office. The District Court, however, dismissed the monopoly leveraging claim prior to trial, and the States unilaterally dropped their monopolization claim with regard to Microsoft Office.

Following a trial, the District Court ruled for the government on three of the four claimed violations, but against it on the exclusive dealing claim. To remedy the violations, the Court ordered that Microsoft be divided into separate operating system and applications software businesses, following a one-year transitional period under interim conduct restrictions.

The Court of Appeals reversed the liability findings with regard to attempted monopolization and tying, dismissing the former and remanding the latter for further proceedings under a more rigorous standard of proof. It sustained the finding of monopoly maintenance, but did so on more limited grounds. Specifically, it reversed the District Court's finding of a course of conduct, limiting liability to specific anticompetitive acts, and with regard to the specific acts, ruled against the government on 8 of the 20 anticompetitive acts sustained by the District Court that the Court of Appeals considered. The Court of Appeals also vacated the remedy, in part because it had so "drastically" curtailed the liability determinations. In discussing the remedy, the Court expressed substantial skepticism about the propriety of structural relief in this case and instructed the new judge to tailor the remedy to the violations affirmed.

The net effect of the District Court's and Court of Appeals' rulings was to substantially narrow both the findings of liability and the bases for relief. The courts ruled against the government with regard to both direct assaults on Microsoft's practice of integrating new

functions into the operating system (the attempted monopolization and tying claims) and Microsoft's ability to use the advantages flowing from the operating system monopoly to enter new markets (the States' monopoly leveraging claim). The sole basis for relief became Microsoft's specific practices — not a course of conduct — to maintain the operating system monopoly by impeding the development and deployment of middleware products. The relief in the proposed Final Judgment effectively addresses these practices by stopping them, preventing their recurrence and restoring the competitive conditions lost due to Microsoft's violations.

## QUESTION

2. Can you tell us more about how this agreement came about, or the process involved in reaching a settlement?

## ANSWER

Particularly while Tunney Act review of the proposed Final Judgment is pending, it would be inappropriate to discuss the details of the settlement process. However, the Department can provide the following general information. On September 28, 2001, Judge Kollar-Kotelly ordered the parties into a period of intensive settlement and mediation discussions to attempt to reach a fair resolution of the case, commencing on September 28, and expiring on November 2, 2001, staying all other case activity during that period. During those five weeks, the Department, certain representatives for the States, and Microsoft extended every effort to comply with the Court's order, first privately, and then with assistance from the mediator appointed by the Court and his partner. After extensive negotiations, the Department, nine of the Plaintiff States and Microsoft were able to agree upon a proposed Final Judgment that would fully meet the Department's goal of achieving a prompt, certain and effective remedy for consumers by imposing injunctive relief to halt continuance, and prevent recurrence, of the violations of the Sherman Act by Microsoft that were upheld by the Court of Appeals, and restore the competitive conditions prevailing prior to Microsoft's unlawful conduct. The settling parties filed a proposed Final Judgment on November 2, 2001, and then a revised proposed Final Judgment on November 6, 2001, which is now being considered by the Court pursuant to the Tunney Act.

Before commencing the settlement discussions, the Department established a set of core principles for resolution of the case, whether by litigation or consent. Key among them was the concept that the remedy had to be a comprehensive set of provisions that would stop the offending conduct and other similar means of achieving the same result, prevent its recurrence, and restore a competitive field for the development and deployment of competing middleware products. Moreover, the relief had to be faithful to the allegations of the complaint actually sustained by the Court of Appeals, addressing the conduct the Court had found to be unlawful. Finally, the remedy had to further the public interest in free and unfettered competition — not dictate market results and not necessarily serve the private interests of certain companies. Settlement occurred when Microsoft was prepared to agree to comprehensive relief satisfying these principles.

## QUESTION

3. Some have criticized the agreement for not going far enough. Do you believe that the proposed settlement compares favorably to-and in some respects may well exceed-the remedy that might have emerged from a judicial hearing?

## ANSWER

The Microsoft case is a public law enforcement action. The settlement, therefore, should be judged on whether it remedies the violations sustained by the Court -- not on whether it is "tough" on Microsoft or "goes far enough" in addressing the concerns of Microsoft's competitors and critics.

The proposed Final Judgment represents, in substantial measure, the relief the Department would have proposed and fought for in court. In a remedies proceeding, however, we would have expected Microsoft to contest vigorously almost every provision extending beyond the literal findings of liability contained in the Court of Appeals' decision. We would have fought hard to obtain this relief, but it is by no means a foregone conclusion that such relief would have been ordered. A few examples illustrate the point.

1. The original case identified Web browsers and Java technologies as potential threats to the operating system. Both were broad-based middleware products with the potential to permit cross-platform (*i.e.*, multiple operating system) development of a broad range of application software products. The current crop of middleware products (*e.g.*, media players and instant messaging systems, etc.) tend to be category-specific, and are more likely to be platforms for narrower families of related applications. For this reason, among others, we would have expected vigorous litigation over the middleware definition and the need to extend the coverage of the proposed Final Judgment to products beyond the browser and Java. Our definition, however, expressly recognizes other middleware products currently in use (*e.g.*, e-mail client software, networked audio/video client software, instant messaging software) and is broad enough to include future products that have the potential to threaten the operating system monopoly.
2. Microsoft's Windows products employ closed, proprietary technology. The company is under no general legal obligation to disclose or license its technology. Moreover, the Court of Appeals did not sustain any allegation that Microsoft's failure to disclose or license its technology (generally or, in particular, its applications program interfaces ("APIs") or communications protocols) was, by itself, an act of monopoly maintenance. Thus, we would have anticipated hotly contested litigation over the imposition of an affirmative Microsoft obligation to assist others in developing competing products. In this regard, Microsoft would have pointed out that tens of thousands of software programs are developed using the standard APIs disclosed generally to the software community. The proposed Final Judgment, however, imposes that obligation as a temporary restorative

measure designed to permit firms to develop competing middleware products that can compete with Microsoft on a function-by-function basis.

3. As discussed above, the case focused primarily on browsers and Java technologies. The word "server" does not appear in the complaint and appears only in passing in Judge Jackson's Findings of Fact. And, neither the Department nor the plaintiff States presented evidence at trial that Microsoft had violated the antitrust laws through conduct related to server software. Thus, we would have anticipated vigorous opposition to any effort to include relief with regard to servers in any litigated judgment. Microsoft would have argued strongly that software that resides on a server is not middleware. Our proposed Final Judgment, however, ensures that independent software vendors will have full access to, and be able to use, the protocols that are necessary for software located on a server computer to interoperate with, and fully take advantage of, the functionality provided by any Windows operating system product.
4. The proposed Final Judgment requires Microsoft to allow competing middleware products to assume "default" status in the operating system (*i.e.*, selected by the manufacturer or user and automatically invoked unless countermanded by a manual choice) and requires the company to make design changes to accomplish that result. These provisions are important to permit competing middleware vendors to develop products that are comparable to Microsoft's in their integration into the operating system. This was not an issue highlighted when the case initially was brought, and the Court of Appeals had ruled against the government with regard to the few specific examples of Microsoft having countermanded a user's Web browser selection. The default provisions of the proposed Final Judgment impose costly and continuing redesign obligations upon Microsoft and likely would have been hotly contested in any litigation.

As you are aware, the government would have borne the burden of proof with regard to all remedial questions.

The proposed Final Judgment secures immediate relief. With regard to the foregoing issues and perhaps many others, a litigated resolution most likely would have been subject to additional appeals taking many months, if not years, including appeals to the Supreme Court on the liability finding itself.

## QUESTION

4. This litigation has been going on for almost 4 years. Will this settlement accelerate the point in time at which a remedy will begin to take effect?

## ANSWER

Although the proposed Final Judgment must still be reviewed by the District Court under the Tunney Act process, the remedy contained in the Final Judgment took effect on December 16, 2001, pursuant to the stipulation signed by Microsoft to abide by its terms. The remedy applies to Microsoft's conduct nationwide and has a term of five years. Given the substantial likelihood that Microsoft would have availed itself of all opportunities for appellate review of any non-consensual judgment, the Department estimated that a litigated result would not have become final for at least another two years, and perhaps much later. The remedies contained in the proposed Final Judgment are not only consistent with the relief that the Department might have obtained in litigation, but they have the advantages of immediacy and certainty.

## QUESTION

5. Assuming the settlement is approved by the court, can you outline the steps that will be taken to ensure compliance with the settlement?

## ANSWER

A core team of experienced lawyers and economists established within our newly formed Networks & Technology Section, and including members of the litigation team, is charged with enforcement of the proposed Final Judgment. This enforcement team, assisted by the technical committee formed under the proposed Final Judgment, will monitor Microsoft's compliance with the Final Judgment and take any necessary action, up to and including initiating contempt proceedings, to ensure effective enforcement.



**QUESTION**

6. Are you aware of this type of enforcement mechanism being adopted in any other antitrust proceeding?

**ANSWER**

The Department is unaware of such a stringent enforcement mechanism being adopted in any other antitrust proceeding.

## SENATOR KOHL'S QUESTIONS

### QUESTION

1. Mr. James, a unanimous Court of Appeals held that Microsoft has violated out antitrust laws by illegally maintaining its monopoly. It seems pretty common sense that if we want to fix that violation, the settlement you are advocating should: (1) end the unlawful conduct; (2) avoid a recurrence of the violation; and (3) and undo the anticompetitive consequences of the illegal behavior. Indeed, the Supreme Court has said that we should "deny to the defendant the fruits" of its illegal conduct. As you know, when this case was first filed, one of the main problems was that Microsoft's illegal conduct had nearly driven a competing maker of Internet browsing software - Netscape Navigator - out of business. But today, Microsoft has a greater than 85% share of browsing software. And Netscape is no longer in business as an independent company and no longer is a serious threat as a competing platform.

So I have the following questions: how does this proposed settlement proposal in any way deny Microsoft the gains resulting from its illegal, anti-competitive conduct? Does it do anything, for example, to undo Microsoft's victory in the "browser wars"?

### ANSWER

The sole basis for liability sustained by the Court of Appeals was maintenance of the monopoly in PC operating systems. The courts specifically rejected both the exclusive dealing and attempted monopolization claims, and reversed the tying finding -- the government claims asserting unlawful gain to Microsoft in the market for Web browsers. Thus, within the confines of the case as it exists, there is little or no legal basis for asserting that Microsoft's present share of the browser market is a "fruit" of its unlawful conduct.

Under the monopoly maintenance count, Microsoft benefitted by impeding the emergence of potential middleware threats to its operating system monopoly. While recognizing the "nascent" threat that Web browsers and Java technologies posed to the operating system, the Department conceded, and both courts found, that it was impossible to predict when, if ever, that threat would materialize as to a degree sufficient to have any material effect upon competition in the operating system market.

The proposed Final Judgment seeks to restore the middleware threat as it existed prior to the offending conduct by enjoining conduct to impede the emergence of competing middleware and by requiring affirmative steps to aid in the development of such products. The proposed Final Judgment requires Microsoft to give software developers access to the API's necessary to develop competing middleware, ensures that those products can gain distribution in the OEM channel, permits OEMs to feature competing middleware products, gives third-party middleware "default" status comparable to Microsoft's integrated functions, and prevents Microsoft from retaliating against firms that develop,

promote or distribute competing middleware. Accordingly, the proposed Final Judgment actually enhances the opportunities for competing middleware products beyond those existing prior to the case.

## QUESTION

2. Five years from now do you think it is likely that Microsoft will still have 95% of the operating system market? If so, should this concern us?

## ANSWER

The proposed Final Judgment is not intended to address Microsoft's acquisition of its market position in operating systems. There was never any allegation in the case that Microsoft unlawfully gained its dominant share in that market. Thus, the proposed Final Judgment does not require Microsoft to forfeit its market position in operating systems, but rather ends Microsoft's unlawful conduct, prevents its recurrence and restores the competitive conditions in the middleware market. Whether any of these middleware threats will ultimately lead to the reduction of Microsoft's operating system market share will be determined by the marketplace. The Department is unable to speculate as to what Microsoft's share will be in the future.

## QUESTION

3. We are right now in the middle of the holiday shopping season, and millions of Americans are going to the computer stores to buy new computers. When they reach the store, they have a choice of many different machines made by many different computer manufacturers, such as Compaq, Dell, Gateway, IBM, and HP, to name a few. But when it comes to the software that operates the machine they face a very different picture. With the exception of the machines sold by Apple, the consumer has no choice but to buy a computer pre-loaded with Microsoft's Windows operating system. Is there anything in the proposed settlement agreement likely to change this picture? Why can't consumers have the same competitive choices in computer software - specifically operating system software - as they have today with respect to deciding which machine to buy?

## ANSWER

As stated above, there was never any allegation in the case that Microsoft unlawfully acquired its dominant share in operating systems, and the proposed Final Judgment does not address Microsoft's position in that market. However, the proposed Final Judgment does ensure that competing middleware products will have the opportunity to compete and erode Microsoft's operating system monopoly. The marketplace will determine whether a middleware product becomes sufficiently ubiquitous to pose such a threat to the Windows operating system.

## QUESTION

- 4.(a). Critics of the proposed settlement claim it is full of loopholes, and that these loopholes will make it easy for Microsoft to evade its terms. I'd like to focus on one thing critics argue is an unnecessary loophole. The settlement contains an important provision that lets computer makers load certain types of non-Microsoft software on their machines without any fear of retaliation from Microsoft. But Microsoft can retaliate in some instances. For example, only competing software that distributed at least one million copies in the United States in the last year receives protection. No such protection is imposed upon competing software which has distributed less than one million copies.

Commenting on this provision in the Washington Post, James Barksdale, the founder of Netscape, wrote "Anyone who understands the [computer] industry knows this is no protection, for the new inventor will always be steam-rolled by the powerful Microsoft. The dreamers and tinkerers whose better mousetrap has not yet been proved should just close shop. The ultimate losers are the potential consumers of these lost ideas."

Why is this limitation found in the settlement? Won't it be difficult for software that has not yet been widely distributed to gain a competitive foothold if Microsoft is not required to allow computer users and manufacturers access to it on the desktop? And why isn't Mr. Barksdale right - aren't consumers the losers if Microsoft is permitted to deny such small, start-up software manufacturers access to the computer desktop?

## ANSWER

Mr. Barksdale's commentary misstates the one million copy limitation of the proposed Final Judgment. The proposed Final Judgment prohibits retaliation by Microsoft related to any middleware, no matter how many copies are distributed. Furthermore, under the proposed Final Judgment, a computer manufacturer will have the right to install any competing middleware application, without regard to the number of copies of that competing middleware that have been distributed. The one million copy limitation exists only with respect to the requirements that Microsoft make public the APIs used in its own middleware products and redesign the operating system to provide a competing middleware product "default" status — *i.e.*, the ability to override automatically Microsoft middleware functions integrated into the operating system. The limitation strikes the proper balance between the substantial costs associated with such documentation and redesign efforts, and the competitive potential of products with fewer than one million copies distributed. To do otherwise would have put the operating system in a state of constant flux, which would have had disastrous implications for users and developers alike. Moreover, in a world of about 625 million PC users and software distribution via downloads and direct mail, distribution of only one million copies, rather than sales, installation or usage, is a relatively minor threshold in the software industry today. As you know, Americans routinely receive unsolicited software offers via the mail every day.

## QUESTION

- 4.(b). Please give specific examples of "non-Microsoft middleware products" (as defined in the proposed consent decree, section VI.N.) that have distributed at least one million copies in the United States in the past year, and examples of those that have not.

## ANSWER

A few of the examples available of non-Microsoft middleware products that have distributed at least one million copies in the U.S. in the past year include RealNetwork's media player, RealPlayer, AOL's ICQ instant messaging product, and Opera, a competing Web browser.

The Department is unaware of any non-Microsoft middleware products that distributed less than one million copies in the U.S. in the past year. As explained in response to Question 4(a) above, distribution of only one million copies, rather than sales, installation or usage, is a relatively minor threshold in the software industry today. Once the terms of the proposed Final Judgment become known in the market, the producers of smaller middleware products will be able to target the one million copy threshold by simply using one of the numerous distribution outlets available in the market today, for example, direct-mail.

## QUESTION

- 4.(c). What types of research and/or objective methods are used to measure such distribution today? Which studies or objective criteria did you use to set the one million dollar mark?

## ANSWER

Competing middleware providers will be able to ensure that they can take advantage of the powers granted to them under III.H. of the proposed Final Judgment by simply disclosing the number of copies they have distributed. Distribution numbers are currently publicly disclosed on the numerous sites available for downloading such products, including cnet.com. The Department considered various levels of distribution when deciding the appropriate amount. One million was chosen because it strikes the proper balance between the substantial costs associated with such documentation and redesign efforts, and the competitive potential of products with fewer than one million copies distributed. In fact, one million copies represents well under 1% of the installed base of Windows desktops in the U.S.



## QUESTION

- 5 (a). In the proposed consent decree, with respect to current products, the definition of Microsoft Middleware Product is locked into specific products (section VI.K.1 of the Proposed Final Judgment). Where it is prospective, the definition of Microsoft Middleware Product allows Microsoft to avoid its reach if it does not satisfy all of the elements of the definition (found in section VI.K.2).

Why do you believe this definition is sufficient to restore competition in the middleware market?

## ANSWER

There is no basis for restricting Microsoft's conduct with respect to all types of software. Any restrictions must be limited to the findings in this case, which were that Microsoft took exclusionary acts against software with particular characteristics -- software that had the potential to become platforms for the implementation of other software, thereby threatening Microsoft's operating system monopoly. The Microsoft Middleware Product definition was carefully crafted to ensure that it covers future Microsoft products that have the potential to become such platforms. The definition uses objective criteria that are not subject to manipulation. Either a product fits the definition or it does not. If, for whatever reason, it does not fit the definition, the product will not be one that the proposed Final Judgment was intended to cover.

## QUESTION

- 5 (b). Why is the definition of middleware in the proposed consent decree different from the one used by the D.C. Circuit Court of Appeals, or the one used by Judge Jackson in his interim remedy?

## ANSWER

The Court of Appeals' decision did not seek to define the term middleware in a manner that would suffice for remedial purposes. Rather, the opinion contains descriptive language to aid in the exposition of the issues in the case. For remedial purposes, the definition must be more technical so as to ensure limits within the terms of the liability found and enforceability of the proposed Final Judgment. The Court of Appeals found that Microsoft engaged in anticompetitive practices with respect to two middleware products, Web browsers and Java. Those products were deemed to have exposed a range of APIs so as to have the potential to evolve into an alternate platform threat, thereby threatening Microsoft's operating system monopoly. Not all products that expose APIs have that quality. The proposed Final Judgment adopts a broad definition of middleware that includes the specific products at issue in this case, other specific products that already have emerged as potential alternative platforms, and products that may be developed in the future that may have similar cross-platform qualities.

The middleware definitions in the proposed Final Judgment are different than those in Judge Jackson's order because in the intervening time period the Department refined the definitions to more accurately reflect the competitive objectives of the judgment and to take into account changes in the software industry, including an increased emphasis on downloading as a distribution mechanism.

## QUESTION

- 5.(c). Why is MSN Explorer excluded from the current products that constitute Microsoft Middleware Products in section VI.K.1 of the Proposed Final Judgment?

## ANSWER

MSN Explorer is used largely by consumers who have already chosen MSN as their Internet service provider or who have chosen Hotmail for their email. It is marketed more in that context than as a simple browser. Competitively it has less significance in the browser market than Internet Explorer.

## QUESTION

6. Many believe Microsoft is using its operating system monopoly to gain dominance in other types of software products. For example, five years ago, Microsoft had only about a 20% market share in Internet browsing software. Today it has an 86% share. Five years ago, Microsoft had 43% share in word processing software. Today Microsoft Word software has a 94% market share.

What provisions in the settlement will prevent Microsoft from gaining dominant market shares in new software products, just as it has with respect to other types of software?

## ANSWER

The concept to which you refer is known in antitrust parlance as "monopoly leveraging." The States included a monopoly leveraging count in their complaint in this matter. That count, however, was dismissed by Judge Jackson in pretrial proceedings. U.S. antitrust precedent treats monopoly leveraging claims with much skepticism. Indeed, as the Court of Appeals noted in rejecting certain of Judge Jackson's rulings with respect to Java, U.S. antitrust law does not prohibit a firm, even one with monopoly power, from using advantages gained in one market to enhance its position in an adjacent market. Given the Court's rejection of the monopoly leveraging claim, there is no legal basis in this case for addressing allegations of monopoly leveraging.

## QUESTION

- 7.(a). Mr. James, if this settlement is adequate to restore competition and remedy Microsoft's illegal conduct, why have nine state attorneys general who initially joined the Justice Department in suing Microsoft refused to sign on to the settlement but have instead proposed their own settlement?

## ANSWER

The Department cannot speculate on the possible motives of the various State attorneys general who did not join the settlement.

## QUESTION

- 7.(b). Are you willing to consider modifications to the proposed settlement in order to secure the consent of additional state attorneys general? If so, what modifications would you consider?

## ANSWER

The Department believes that the proposed Final Judgment fully remedies the conduct found unlawful by the Court of Appeals. The Department, however, will fully comply with the Tunney Act, including giving due consideration to the public comments submitted.

## QUESTION

- 8.(a). The proposed consent decree lasts for only five years (unless a Court finds Microsoft has engaged in systematic violations of the decree, in which case it is extended for another two years).

Can you inform me in which past monopoly cases brought by the government where a violation of Section 2 of the Sherman Act has been found, the federal courts have limited their conduct remedies against the monopolist to only five years?

## ANSWER

The Department is aware of at least one Section 2 case in which the government obtained a final judgment that included conduct remedies that were in effect for five years or less — *U.S. v. American Airlines*, Civil Action No. CA 3-83-0325-D, U.S. District Court for the Northern District of Texas (Final Judgment entered on October 31, 1985, *see* 1985-2 Trade Cases ¶ 66,866).

## QUESTION

8.(b). Why have you limited the remedy to five years in this case? How can we be sure that the five year term of the settlement is sufficient to restore competition to this market?

## ANSWER

Five years provides sufficient time for the conduct remedies contained in the proposed Final Judgment to take effect in this evolving market and to restore competitive conditions to the greatest extent possible given the conduct at issue in this case.



## QUESTION

- 8.(c). Why do the restraints on Microsoft's conduct in some instances take as long as one year to go into effect?

## ANSWER

The only provisions in the proposed Final Judgment that do not require Microsoft to immediately abide by their terms once the Final Judgment is in effect are Sections III.D., III.E., and III.H. These provisions provide Microsoft with a limited amount of time to implement the company's duties because they require Microsoft to actually redesign its products or establish new disclosure procedures that could take some time to accomplish. In addition, requiring Microsoft to immediately disclose the unfinished interfaces for its new products in development in Section III.D. would actually be detrimental to the market because Microsoft continuously changes and improves these interfaces before a product is finalized. If the interfaces are changed after a software developer uses them in its products, it may disable both the software product and the operating system. Giving Microsoft a limited amount of time to implement its duties under these provisions ensures that they are properly implemented.

## QUESTION

8 (d). How likely do you think software developers will be to develop new products based on a decree that will protect them for only five years?

## ANSWER

Five years provides sufficient time for the conduct remedies contained in the proposed Final Judgment to take effect in this evolving market and to restore competitive conditions to the greatest extent possible given the conduct at issue in this case. The marketplace will decide what middleware products will succeed.

**QUESTION**

8.(e). Will you commit to initiating new investigations and, if necessary, new court proceedings, if Microsoft behaves in an anti-competitive manner in the future?

**ANSWER**

As a law enforcement agency, the Department will continue to evaluate Microsoft's conduct and take action to remedy anticompetitive conduct where appropriate.

## SENATOR DURBIN'S QUESTIONS

### QUESTION

- 1.A I understand that the Justice Department officials, representatives of the State Attorneys General, and Microsoft lawyers worked around the clock to come to an agreement on this settlement.

How many meetings were there on the settlement?

### ANSWER

The proposed Final Judgment resulted from a process of court-ordered settlement discussions and mediation, commencing on September 28, and concluding on November 2, 2001, the deadline imposed by Judge Kollar-Kotelly. The mediation followed upon about two weeks of court-ordered, unsupervised discussions among the Department, counsel for Microsoft and representatives of the plaintiff States. Although we did not meet continuously, throughout both periods, there were communications among the parties every day, in-person or telephonically, and the settlement teams, more often than not, worked well into the night. The Department, however, did not maintain an accounting of the number of meetings or communications during the settlement discussions.

## QUESTION

1.B. Were the states sufficiently involved in the process?

## ANSWER

Following the Court's September 28<sup>th</sup> Order, the Department was advised that the State coordination group would appoint representatives to participate in the settlement discussions and that the representatives would report to the larger group through regular conference calls and other means. Once the mediation commenced, the States were continuously represented by the states of Ohio and New York, with Wisconsin actively participating on some occasions. All three of these states joined in the proposed settlement.

The Department worked to facilitate the States' participation in the settlement process. Among other things, the Department permitted the State representatives to work in its case room, side-by-side with the Department staff. State representatives participated in strategy sessions with the Assistant Attorney General and other senior representatives from the Department prior to their joint negotiating sessions. At critical junctures in the settlement process, the Assistant Attorney General convened meetings, in-person or via scheduled conference calls, with the State coordinating group, which meetings were often attended by several State attorneys general and their staffs or representatives. Additionally, the Assistant Attorney General maintained regular telephonic communication with Iowa Attorney General Tom Miller, the appointed leader of the State plaintiffs.

The mediators also took steps to encourage full participation by each of the States. At the outset, they inquired as to whether representation of the State plaintiffs by Ohio, New York and Wisconsin was adequate to ensure that all the States would be in a position to carry out the Court's order. The mediators met with the State group separately on several occasions. In the end, they requested that all interested States send authorized decision-makers to Washington for the final stages of mediation.

In short, the States, individually and as a group, were afforded every opportunity to participate in the settlement process, and did so on terms they themselves agreed upon. The States had full access to the process, including all drafts of the settlement documents. At no time were the States precluded from tendering settlement proposals or alternative drafts of the settlement provisions of their own, and in fact, were expressly invited to do so by both the mediators and representatives of the Department. As with other phases of the case, the level of actual State participation varied widely.

It is not for the Department to opine whether the States participated sufficiently in the settlement process. We would note that the States that participated most directly in the process joined in the proposed Final Judgment, and those that participated only indirectly or not at all chose not to do so.

## QUESTION

- 1 C. Was there anyone in the room during those negotiations who was not affiliated with the parties to the litigation who may have been able to bring another perspective on the terms of the agreement?

## ANSWER

The court-ordered settlement discussions that were conducted prior to the appointment of the mediators on October 12, 2001, did not include individuals unaffiliated with the parties to the litigation. The only persons present during the settlement discussions after October 12 who were not affiliated with a party were the Court-appointed mediator, Eric Green, and his partner, Jonathan Marks.

## QUESTION

2. Now that we are in the 60-day period of the Tunney Act proceeding to determine the public interest aspects of this settlement, what, if any, role do you envision Congress should play?

## ANSWER

The Department would not presume to tell Congress what, if any, role it should play with regard to Tunney Act review of the proposed Final Judgment.

## QUESTION

3. Microsoft is about to settle with about half the states who joined in the original DOJ lawsuit, but the other half of the states are continuing with the court-issued remedies phase of the litigation. Naturally, there may be differences in the remedies in the two different vehicles for closing out this case. How will you reconcile the potential differences between the terms of the settlement accepted by the nine settling state plaintiffs and the remedies to be awarded to the ten non-settling state plaintiffs?

## ANSWER

In any multiple-plaintiff litigation, there is the possibility of different, perhaps conflicting, remedies. In private antitrust litigation, where the issue is monetary recovery or the rights of individual companies, disparate outcomes may be manageable. The Microsoft case, however, presents a circumstance in which both the federal government and several state governments are purporting to litigate substantially identical substantive allegations and seeking injunctive relief that would have national public policy implications, affecting the rights of consumers and producers nationwide. With the states increasingly opting to pursue antitrust cases following upon charges already being litigated by the federal antitrust enforcement agencies, the risk of conflicting or inconsistent remedies is always present. In multiple-plaintiff cases, the courts and parties typically undertake to prevent such conflicts from occurring. All parties, of course, would be bound by the orders of the court, and meaningful conflicts could become the source of future litigation.

The Department believes that the proposed Final Judgment represents a full and complete resolution of the violations sustained by the Court of Appeals and that entry of the proposed Final Judgment is strongly in the public interest. Whether or not conflicts emerge, as the agency charged with ensuring that the federal antitrust laws are duly enforced for the benefit of all Americans and the U.S. economy as a whole, the Department will do all in its power to ensure full compliance with the proposed Final Judgment and to protect the antitrust enforcement process itself.



Answers to Written Questions .  
The Senate Judiciary Committee,  
"The Microsoft Settlement: A Look to  
the Future"

Lawrence Lessig  
Professor of Law,  
Stanford Law School

## QUESTIONS FROM SENATOR HATCH

1. In your book, you make the case for keeping the Internet "neutral and open." Could you briefly describe the danger that you foresee, in both a competition and a larger policy context, as consumers migrate to higher capacity connections from our current narrowband connections?

The broadband policy of the current administration will weaken the environment for innovation on the Internet, because current policy will balkanize the Internet, and hinder the opportunity for outsiders to compete.

As consumers move from narrowband to broadband, the legal rules governing at least part of the network are changing. The narrowband Internet was governed by rules that required neutrality by the network owners over the use of the Internet. The broadband Internet will be governed by rules that increasingly allow the network owners to pick and choose the kind of innovation and content that the network will carry. This change in legal rules will shift the locus of innovation from the edge of the network to the center -- away from the broad range of creators and innovators that have built the Internet so far, to the relatively few who own or who control the network. What runs well on this Internet will increasingly depend upon who the network owner is.

These changes are said to be necessary in order to support the building of the national information super highway. In my view, Congress should weigh this claim much more

carefully. It is true that giving broadband providers this power to discriminate will increase their incentive to build broadband pipes. But before we sell the soul of the Internet to the network owners, a much stronger showing of need should be made. We didn't give GM the right to build the interstate highway system in exchange for GM's right to build the roads to favor GM trucks. Nor should we sell the Internet to broadband providers in exchange for their right to favor some content over others, or choose which applications will define the Internet of the future. In both cases, the strong presumption should be in favor of neutrality. Congress should weigh the costs of corrupting this principle of neutrality before it endorses a policy that permits this rearchitecting of the Internet's core.

2. One concern I have consistently raised elsewhere, including in merger and monopolization contexts, has been possible limitations being placed on consumer freedom by an access provider, whether an Internet service provider, a cable company, a satellite company, or another Internet access facilitator. Is there is a legitimate fear that an Internet mediator might -- for one reason or another -- decide to limit access to certain sites or drive traffic to other specified sites? If so, what do you believe to be the best method of safeguarding and preserving the freedom of the Internet?

It is right to be concerned that access providers will wrongfully constrain consumer freedom. Technology companies have already developed router technology to enable network

owners to choose which content will flow quickly, and which content will flow slowly. This technology could enable the blocking of some content, or the disabling of some applications. Cable companies carrying Internet content have already indicated their intent to implement these technologies. And there is nothing this administration is doing that would slow this trend.

The concern about neutral access to the Internet is similar to the concern about access to satellite or cable broadcasts generally. But I believe it is a mistake to equate the two. The harm to innovation and creativity from restrictions to the Internet is more fundamental than the harms caused by restrictions to entertainment.

The reason is that access to entertainment competes directly with many other channels of entertainment. If the choice on cable television is too narrow, then Blockbuster or Netflix provides useful competition. If satellite stations become too expensive, then cable television, or broadcast television — or maybe even a book! — continue to compete. At some point concentration in these channels is a concern, as Jack Valenti has powerfully and rightly testified to Congress.<sup>1</sup> But that

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<sup>1</sup> See, e.g., *Media Ownership: Diversity and Concentration: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong. 611 (1989) (statement of Jack Valenti, President and CEO, MPAA).at 611 ("Therefore, in this free and loving land in which we live, our government ought never allow any tiny group of corporate chieftains or corporate entities, no matter how benignly managed, to ever reassert full dominion over prime time television, which is the most pervasive moral, social, political and cultural force in this country.").

concern is different from the concern I have about the Internet. The Internet is not just, or not only, another way to be entertained. It is instead a platform that will support the broadest opportunity for social and democratic engagement. The Internet is a public street, or park, or library, not a Movieplex. Restrictions on access and control of the Internet are like restrictions on access to the public streets, not like choices Sony Pictures makes about what will run in first-run theatres.

Thus, in my view, you have been right to be concerned about restrictions on access in the context of cable and satellite delivery of entertainment and news. And you have been right to be concerned that citizens generally have access to news about matters of public import. But there is an even stronger reason for you to be concerned with restrictions on access in the context of the Internet. Much more is at stake.

I am not certain about the best remedy to this non-neutrality. Network owners have a legitimate interest in selling different levels of service; the market should be allowed to experiment with different modes of delivery. Where there are many different competitors offering comparable broadband service, there is little role for government. But where competition is not adequate, then there is an oversight role for government. "Open access" requirements are one indirect response to the absence of competition. Alternatively, a simple requirement that any Internet service be implemented neutrally may suffice to remedy any anticompetitive threat.

**3. As you know, on the Internet, anyone can self-publish their music, their artwork,**

their writings, and those who are interested in those works can have access to them, and neither the creator nor the consumer necessarily need the mediation of a publisher. Works that are important to a few, but cannot make it in a traditional publishing context, have a place for their fans on the Internet. I have said elsewhere that it would be a great shame if the wide-open access available on the Internet were narrowed down in the way the offline world often is. Could you please explain who you believe should choose where a consumer can go online, the consumer or the Internet mediator, be it an Internet service provider, a software company, or a cable or satellite company, and could you explain why this is an important question?

Losing the freedom of choice that the original architecture of the Internet guaranteed would be far more than a "great shame." Losing the freedom of choice that the original architecture of the Internet guaranteed would be a betrayal of the values of free speech and competition that define our political and social culture.

The original architecture of the Internet showed the world how a decentralized, market-based, neutral platform for innovation could enable the broadest range of creators to produce and exchange creative work. This was not the speculation of some utopian academic or technologist. The early Internet made this possibility a reality, and none can deny the opportunity it created.

This reality is being changed now, as the original architectural principles of the Internet become corrupted by network owners. As the Internet moves to broadband technology, broadband providers are changing the effective architecture of the original network to re-vest in them control over how innovation on this network proceeds. The original Internet vested that control in consumers and innovators; the new Internet will return that control to the network owners.

This change is happening because government policy encourages it to happen. We are selling the soul of the Internet to network providers because the network providers have convinced policy makers that this is the only way to build out a broadband network.

The network providers in my view are wrong. The policy makers who follow them are misguided. But at a minimum, whether you believe they are wrong or not, Congress has yet to consider the full cost of this corruption in the Internet's core.

I believe fundamentally in the freedom of a network where the people, not, as you rightly describe it, "a network mediator," choose the future. That freedom is the original Internet, which because of its "end to end" design, assured that citizens, not network mediators, controlled how the network developed. There is no good justification for permitting network providers the power to corrupt that original freedom. Yet this is precisely what current administration policy is allowing.

You have been an admirable advocate of balance, Senator Hatch. That balance is just what is needed now in this debate over the network's future.

QUESTIONS OF SENATOR DEWINE

1. Mr. Lessig, you stated in your testimony that an appropriate remedy should try and steer Microsoft toward developing its strategy in regards to the Internet. First, why wouldn't such an objective fall outside the clear confines of the case and thus be an inappropriate goal for a remedy? And second, given the fact that a court found Microsoft to have engaged in significant violations of the antitrust laws, should we be concerned about the company attempting to leverage its operating system monopoly to become dominant at the Internet level?

If this market were stable, and technological progress slow, then it would be appropriate to confine a remedy to the retrospective harm caused by the illegal behavior of Microsoft. But this market is neither stable, and fortunately, progress is not slow. Instead, the particular wrongs that Microsoft was found guilty of are essentially irrelevant to the current competitive context. Forcing a remedy with respect to these alone would neither "'unfetter [the] market from anticompetitive conduct,' 'terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation,'" nor "'ensure that there remain no practices likely to result in monopolization in the future.'" *United States v. Microsoft Corporation*, 253 F.3d 54, 103 (D.C. Cir 2001).



It is for this reason that I believe that the essence of an appropriate remedy must look forward, and ask how best to steer Microsoft in a pro-competitive direction. Given the findings of liability by the District Court, and the pattern of behavior that they affirm, I do believe that you should be worried that Microsoft will try to protect its OS monopoly by leveraging it to control at the Internet level. But as I describe more fully in my written testimony, I also believe that there is a strategy that Microsoft could adopt that would not threaten competition at the Internet level, but could instead strengthen it. If a remedy could steer Microsoft to adopt this competitively benign strategy, that remedy would be a crucial gain for competition generally — even if it did not fully right the wrongs caused in the past.

2. Mr. Lessig, you stated in your testimony that an integral part of the Court's conclusion was its finding that Microsoft had "commingled code" in such a way as to interfere with the ability of competitors to compete on an even playing field. Do you believe the Justice Department's proposed final judgment adequately deals with this anticompetitive conduct?

I do not believe the proposed final judgment is responsive to this concern. The Court of Appeals recognized a second and important way in which a monopoly firm in a technology market can improperly use its power to inhibit competition. Not only can such a firm use *contracts* to restrain competition, it can also use computer code to constrain competition. The essence of the

District Court's finding was that Microsoft had used its code strategically to disable or hinder competition rather than to give consumers a better choice. That finding was twice upheld by the Court of Appeals — both in its initial opinion, and in the opinion rejecting Microsoft's petition for rehearing.

I am particularly concerned that this aspect of the case is now being ignored by the government. In a recent interview with the Wall Street Journal, for example, Assistant Attorney General Charles James is reported to have said, in response to the observation that "various Internet features are woven more deeply into Windows, offering consumers such benefits as one-click access to the Internet from electronic mail,"<sup>2</sup>

"How would consumers be served if we forced Microsoft to remove that code? ... The market has changed."

This statement betrays a fundamental misunderstanding about the issues in this case as it was litigated and decided by the District Court. No one has ever questioned Microsoft's right to include code that would enable better functionality — in this case, the ability of a user to link from an email message to a browser. The only issue has been the decision by Microsoft to use its power over its code to inhibit consumer choice of which browser. Microsoft has consistently argued that it did not interfere with consumer choice. The District Court and Court of Appeals found to the contrary. See, e.g., *Microsoft*, 253 F.3d at 66. And in rejecting

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<sup>2</sup> John Wilke, *Hard Drive: Negotiating All Night, Tenacious Microsoft Won Many Loopholes*, Wall Street Journal, A1 (11/9/01).

Microsoft's request for rehearing about the "commingled code" finding, the Court of Appeals reaffirmed a central aspect of the case: That Microsoft had used its power to design its code in a way that restricted consumer choice without any compensating competitive benefit.

Nothing in the proposed remedy directly addresses this concern. But more troubling to me is that the government seems no longer to even understand it. After convincing a district and appellate court of its view about Microsoft's behavior, the government seems now to have adopted Microsoft's view of its behavior. I have seen no justification offered by the government for this reversal on a central element of its case.

3. Mr. Lessig, you mention that there are problems with the proposed decree aside from enforcement. What are some of the other areas of concern?

As I have just mentioned, the failure of the decree adequately to address "commingled code" is a significant problem. I also believe the failure to require disclosure in the context of security protocols is a significant weakness, as is the failure of the decree fully to define "retaliation."

These weaknesses have been adequately described, in my view, in the Nine Remaining States' December 7<sup>th</sup> filing with the district court. Except for the questions that I have raised about that filing in my written testimony, I agree generally with the concerns raised by those states.

4. Mr. Lessig, what do you believe are the appropriate objectives of remedies in

monopolization cases such as this? Do you believe the case law supports a position that monopoly acquisition cases should be treated differently than monopoly maintenance cases? Finally, do you believe this settlement fully achieves the appropriate remedy objectives? If not, in what way is it deficient?

As the Court of Appeals rightly indicated, the objective of a remedy in a monopolization case is extremely broad. *Microsoft*, 253 F.3d at 103. In general terms, its aim is to recover from the monopolist the fruits of its illegal activity, and assure it can no longer benefit from those illegal gains.

In my view, it is impossible fully to achieve these results in a context where technologies are changing rapidly. The problem is much like trying to remedy any harm caused by the choice of the QWERTY keyboard — at this point too much has been built on the underlying technology, and any remedy that seeks to completely undo what has been done would be more costly than beneficial.

Thus, I think the appropriate distinction for the court to focus is not between monopoly acquisition and monopoly maintenance cases, but between cases where technology is relatively stable, and cases where it is changing quickly. As I've indicated, I don't believe the current remedy achieves the appropriate objectives, given the nature of the changes in the underlying technology.

QUESTIONS OF SENATOR KOHL

1. Professor Lessig, do you believe this settlement is adequate to restore competition in the computer software industry? Why or why not?

The settlement is not adequate to restore competition in the computer software industry. Because the settlement has no effective mechanism for enforcement, it tempts Microsoft to continue the strategic behavior that the District Court and the Court of Appeals found violated the antitrust laws. As this case demonstrates, if it takes four years for Microsoft to "understand the [government's] concerns," Statement by Bill Gates, November 6, 2001, then by the time Microsoft gets it, the harm is already done.

2. (a) Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? If so, what are they?

As I indicated to Senator Dewine, I do believe that there should be additional restrictions on Microsoft's conduct, especially relating to Microsoft's ability to "commingle code." But those additional restrictions are secondary to an effective mechanism to enforce the decree. As I indicated in my written testimony, without an effective enforcement mechanism, the balance of the restrictions are irrelevant, and with an effective enforcement mechanism, the weaknesses in the restrictions may not matter.

2. (b) Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you

believe should be fixed before it is approved? If so, what are they?

The central weakness in the decree is its failure to include an adequate mechanism to enforce the decree. Given the slowness of federal court intervention, the decree creates an effective and continuing incentive for Microsoft to behave anti-competitively. If there were an effective enforcement mechanism (such as an adequately empowered special master), then that incentive would disappear.

3. Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software does not apply with respect to software which has distributed less than one million copies. Are you concerned with this limitation?

I am. I do not see what legitimate interest the limitation serves. The aim of the decree generally is to enable Original Equipment Manufacturers (OEM) autonomy — to enlist OEMs in the competitive process of deciding what bundle of software makes most sense for the consumer. Any burden from new software bundled with an operating system is borne by OEMs, not Microsoft. By establishing that OEMs only have the right to bundle new software if 1,000,000 consumers have downloaded that software on its own, the decree significantly reduces the incentive OEMs have to discover and distribute new, competitive software. This is a significant loss in potential competition that does not, in my view, have any justifying benefit.



January 10, 2002

Senator Patrick Leahy  
Chairman  
Committee on the Judiciary  
United States Senate  
Washington, D.C. 20510-6275

Dear Chairman Leahy:

Thank you very much for the opportunity to respond to written questions from the members of the United States Senate Judiciary Committee. My written responses are attached.

We appreciate the Committee's attention to this matter. Please let me know if you have any additional questions or concerns.

Sincerely,

Mitchell Kertzman  
Chief Executive Officer

Cc: Nicolle Puopolo  
Senate Judiciary Committee  
224 Dirksen Senate Office Building  
Washington, D.C. 20510  
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Date: 1/10/2002 10:43 AM  
Sender: Mark Webbink <mwebbink@redhat.com>  
To: nicolle puopolo  
Priority: Normal  
Subject: Microsoft Hearing - Written Questions - Responses of Matthew

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Dear Nicolle,

Attached are the responses provided by Matthew Szulik, President and CEO of Red Hat, Inc., to those written questions submitted by Senator Leahy in his letter of December 19. I am forwarding a hard copy by Federal Express which you should receive tomorrow.

Mark Webbink  
Sr. VP and General Counsel  
Red Hat, Inc.

Response to Written Questions  
United States Senate Judiciary Committee  
Hearing regarding "The Microsoft Settlement: A Look to the Future"  
December 12, 2001

#### Hatch #1

The nine states have chosen to litigate for substantially more than the settlement offers. Commentary that presupposes that the judge will rule against the nine attorneys general in the pending case is tantamount to a request for a denial of due process. In the recent hearing in which Judge Kollar denied Microsoft an extension of time in which to hear the proposed alternative remedies of the nine states, Judge Kollar also found the proposed alternative remedies to be within the scope of remedies permitted under the order of the Court of Appeals.

The fact remains that the settlement has many substantial structural flaws, each of which can be used independently to circumvent the intended remedy, and all of which together provide Microsoft with a range of options for continuing their abusive behavior and extending their monopoly further. We believe it is vital, not just for the states and the people they represent, but to the technology industry as a whole, that Microsoft not create a monoculture that can collapse catastrophically, but that competition be preserved, so that no single failure can destroy everything. The fact that further consideration of this matter may take an additional two months or two years should not override the public's interest in having Microsoft behave in a legally permissible manner.

#### Hatch #2

Absolutely. The first issue is to address the obvious technical loopholes and structural flaws that have been identified, as well as to review a revised settlement to address the states' primary concerns:

1. Will Microsoft agree to alter its behavior and cease to stifle innovation and competition by abusing its monopoly? And,
2. Will the settlement offer sufficient powers to enforce actions against Microsoft if it violates the terms of the settlement?

Clearly, Microsoft has settled before, and clearly those settlements proved completely ineffective. No attorney general can, in good conscience, agree to a settlement that will lead to

continued abuse through lack of sufficient prescriptions or lack of sufficient enforcement, or both. There are a substantial number of legal authorities who believe that the remedies contained in the Proposed Final Judgment will do nothing but prompt another round of litigation in the future due to their ineffectiveness.

#### Hatch #3

A prompt settlement that does nothing except to remove the case from the court will accomplish nothing. The imperfections of the current settlement are so great that we believe it to offer nothing whatsoever to any damaged party, period. As written, the settlement will give Microsoft another 5 year ticket to extend and abuse its monopoly position, and will be an even more formidable adversary 5 years hence. One must also consider why this litigation has been so long in coming to a resolution. That burden does not lie on the Department of Justice and the states. Rather it lies on Microsoft for delaying, albeit within the scope of due process, the resolution of the matter. Our government must have the fortitude to see such matters through to a full and proper conclusion, not cave in to a delaying action intended to exhaust patience.

#### DeWine #1

The comingling question focuses on a specific symptom, not the root cause. The root cause is that Microsoft is able to use technical means to create de facto standards. Such standards, when placed strategically, are the seeds to future monopoly positions. Debating the issues of comingling and removal of code can shed light on the subject, but only give us a shadow view of the true questions. We believe that remedies proposed by the nine states about providing documentation, licenses, and in some cases, source code, provides the kinds of remedies which can then be debated in the context of comingling vs. third-party software.

#### DeWine #2

The current Proposed Final Judgment offers nothing to foster innovation and competition in the market of commercial operating systems. In fact, it may do quite the contrary. During the entire litigation, Microsoft has been a significantly less fierce competitor than they might otherwise have been. If the Proposed Final Judgment is imposed on all parties without modification, it will actually sanction Microsoft's past abusive behavior, and there will be nothing to stop Microsoft from escalating their anticompetitive behavior while remaining within the guidelines of the Proposed Final Judgment. The proposal offered by the litigating states, on the other hand, offers true structural remedies and strong enforcement, creating an environment that will foster innovation and competition, increasing the ability of all technology companies, to invest with greater confidence that they are doing so in a fair and free market environment.

#### Kohl #1

Not at all. The settlement contains technical and structural loopholes that legitimize, rather than remedy, Microsoft's abusive monopoly. For example, sectiona III J.1 and III J.2 both grant Microsoft sole discretion to determine the applicability of the settlement to its own business practices where such practices have in the past been used to extend and abuse monopoly power. Thus, the settlement is little more than an opportunity for Microsoft to change its own behavior based on its conscience, not

a proscription from the courts. Microsoft has demonstrated, in the case of previous settlements, that they are already acting out their conscience and that the technology industry, the states, and the public are not safe from such actions.

Kohl #2 (a and b)

We are strongly supportive of the nine states' comprehensive alternative to the proposed settlement. We believe that the Proposed Final Judgment as currently drafted cannot easily be fixed by simply fixing errors and omissions. Instead, a comprehensive alternative, written by the plaintiffs rather than the defendant, should be considered.

Kohl #3

There are over 100,000 software companies in existence today (source: Craig Mundie, Microsoft SVP of Advanced Development debating Red Hat CTO Michael Tiemann at the O'Reilly Open Source Conference, July 2001), yet only 500 software companies in the Software 500. Of those 500, the vast majority ship fewer than one million copies of anything. Thus, setting the bar at one million copies excludes more than 99.9% of all software companies from receiving any relief whatsoever with respect to this part of the settlement. Of course, several other parts of the settlement also allow Microsoft to further expand and abuse their monopoly position, so the question by itself is more symptomatic rather than fundamental.

Kohl #4

This Proposed Final Judgment will make it harder, not easier to compete, because it will legitimize, rather than remedy Microsoft's abusive behavior. While we believe that on a daily basis Microsoft behaves in ways inconsistent with this settlement (using retaliation or threats of retaliation or coercion against protected classes defined by the settlement), they have been somewhat restrained while the litigation has been pending. If the settlement is accepted, Microsoft will be able to continue the expansion and abuse of their monopoly with impunity, because the settlement actually allows that! Yes, they may have to change some behavior, but fundamentally the proposed settlement gives them all they need to maintain their current status quo. Further litigation is a very expensive way to reduce a defendant's capacity to do further damage, and we would certainly prefer a settlement that actually addresses and remedies Microsoft's abuses. But as written, this proposed settlement addresses and remedies nothing of substance, while giving Microsoft the "all clear" to resume its unhealthy control of innovation and competition. It should be of interest that Red Hat, in markets where Microsoft does not enjoy a monopoly, has been able to compete on technology, performance, and cost. At the same time, Red Hat has elected not to enter the Intel-platform based desktop market, viewing such an effort as futile given Microsoft's monopoly position. Nothing in the Proposed Final Judgment would cause Red Hat to alter that position.

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Date: Thu, 10 Jan 2002 10:43:28 -0500  
From: Mark Webbink <mwebbink@redhat.com>  
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Szulik  
To: nicolle\_puopolo@judiciary.senate.gov  
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## Responses of Charles F. Rule to Judiciary Committee Questions

### Leahy Questions

- Q1. *In your 1997 testimony on the first Microsoft-Department of Justice consent decree, you said that "it seems a bit shortsighted (or perhaps even hysterical) to believe that Microsoft is such a juggernaut that putting extra sand in its saddle bags is justified to even up the odds for the competition." In light of the fact that the Court of Appeals found that Microsoft violated Section 2 of the Sherman Act, abusing its operating system monopoly to the detriment of consumers, do you still believe that it is "hysterical" to inquire into, and seek to end, the company's anticompetitive practices?*
- A. As you note, the statement in my 1997 testimony refers to the enforcement action brought by the government alleging that Microsoft had violated the terms of its 1995 consent decree. Microsoft was ultimately vindicated in that action, with the Court of Appeals finding that Microsoft had done nothing to violate the terms of that decree. In this most recent action, the Court of Appeals did conclude that certain of Microsoft's practices amounted to monopoly maintenance that violates section 2 and, as my statement to the Committee in December of 2001 explains, the Revised Proposed Final Judgment addresses all that conduct and much more. Having said that, it is worth noting, first, that the Department and states have never alleged, much less proved, that Microsoft achieved its position in the market illegally. Moreover, as the Court of Appeals held, "the District Court expressly did not adopt the position that Microsoft would have lost its position in the OS market but for its anticompetitive behavior." *United States v. Microsoft Corp.*, 253 F.3d 34, 107 (3d Cir. 2001). Second, no matter how one chooses to characterize Microsoft's (or any other company's) competitive prowess, it is never appropriate for the antitrust law -- nor is it good policy generally -- to put "sand in the saddle bags" of one competitor simply because it is more successful for reasons of skill, foresight or luck. Prohibiting companies from engaging in illegal practices and requiring them to compete on the merits is clearly critical, but "rigging" or trying to alter outcomes of competition on the merits is a bad idea.
- Q2. *The Tunney Act requires that Microsoft file with the district court "any and all written or oral communications by or on behalf of [Microsoft] . . . with any officer or employee of the United States concerning or relevant to such proposal, except that any such communications made by counsel of record alone with the Attorney General or the employees of the Department of Justice alone shall be excluded from the requirements of this subsection." You have recently been named as counsel of record; do you believe that this provision requires disclosure of communications by you to the Justice Department prior to the date upon which you became counsel of record? Do you believe it requires disclosure of contacts made on behalf of Microsoft to members of Congress? How do you define*

power in a way that would be very difficult for courts to redress in the future without recourse to draconian structural relief. Finally, as we saw with the 1995 consent decree, having a seriously flawed settlement can sometimes be worse than having no settlement at all, insofar as it lulls enforcement agencies and the public into a false belief that anticompetitive conduct has been checked while it in fact continues, compounding the underlying problems in the marketplace. Some in the industry have argued that but for the pendency of the current litigation, and the public and judicial scrutiny that resulted, Microsoft's conduct in the marketplace would have been even worse.

*"concerning or relevant to" the proposed settlement? Do you believe that it covers anything more than the actual negotiations of the decree?*

- A. First, I personally have been counsel of record for Microsoft since the appeals of Judge Jackson's decision began in 1999. (For those interested, they should review the briefs filed with the Supreme Court and the Court of Appeals.) Moreover, since Microsoft's negotiations with the Department of Justice included representatives of the Plaintiff states, the Tunney Act disclosure includes disclosure of all the negotiations of which I was a part.

Second, the Tunney Act only requires disclosure of contacts with the Executive Branch. To my knowledge, disclosure filings in Tunney Act proceedings (including AT&T's disclosure, for example) are limited to contacts with the Executive Branch.

Third, there is no reason to believe that the phrase "concerning or relevant to" has any meaning other than the standard definition of the words. Webster's New Collegiate Dictionary indicates that "relating to" and "regarding" are synonymous for "concerning." "Relevant" is defined as "having significant and demonstrable bearing upon the matter at hand." Accordingly, and consistent with the plain meaning of all the words of the statutory provision you quote, Microsoft's disclosure included reportable contacts by Microsoft or its representatives with the Executive Branch that related to the company's negotiations of the settlement with the Department and the Plaintiff states.

- Q3. *Microsoft's retaliation against OEMs that resisted carrying Microsoft's products featured largely in the evidence at trial, and the proposed settlement seems to address the Court of Appeals' holding that such retaliation violated Section 2 of the Sherman Act. While the settlement does state that Microsoft cannot retaliate against an OEM that is supporting a competing operating system or middleware there is also a "carve-out" to that restriction, which permits Microsoft to provide "consideration to any OEM with respect to any Microsoft product or service where that consideration is commensurate with the absolute level or amount of that OEM's development, distribution, promotion, or licensing of that Microsoft product or service." This seems to permit Microsoft to reward OEMs based on whether they carry Microsoft's products or software; this is just the flip side of "retaliation." How is this different from punishing those who fail to accede to Microsoft's demands?*

- A. It is important to note that the Court of Appeals did not conclude that Microsoft "retaliated" against any OEM for shipping any competing software (or for any other reason). Moreover, the anti-retaliation provisions of the Revised Proposed Final Judgment contain no "carve-outs." Rather, Microsoft may not retaliate against OEMs, ISVs, and IHVs (independent hardware vendors) because they develop, etc., software that competes with the Windows PC operating systems or Microsoft Middleware. The provision prohibits "retaliation" as that word is

commonly understood and defined. The provisos in the relevant sections of the Revised Proposed Final Judgment do not “carve-out” exceptional circumstances in which Microsoft may retaliate against these third parties for their development, etc., of competing software; rather, those provisos simply make certain that in the future no one will try to extend the prohibition to certain conduct that is legitimate and not generally understood to be “retaliation.” So for example, the Revised Proposed Final Judgment is written to ensure that it will not be possible to twist the common meaning of “retaliation” to cover situations in which Microsoft seeks legitimately to protect its intellectual property against infringement. The decree also makes clear that legitimate efforts by Microsoft to enforce a contract, including through rights of termination against an OEM that has breached the contract by, for example, refusing to pay royalties due and owing to Microsoft, though Microsoft agreed that it would give an OEM an offer to cure any breach at least two times during the term of the contract (which currently is one year) are allowed under the Revised Proposed Final Judgment.

Also, as your question indicates, the Revised Proposed Final Judgment makes clear that Microsoft is not “retaliating” if it provides ten times more marketing support to one OEM than to another OEM that ships only one-tenth the number of Windows operating systems compared to the first OEM. The notion that Microsoft has to provide the same level of support to all third parties without regard to the level of development, distribution, promotion or licensing of Microsoft’s products or even without regard to whether they carry Microsoft’s products or software at all seems absurd. One doubts that OEMs like Dell and Compaq that each year sell millions of PCs installed with a Windows PC operating system would think it fair and reasonable if Microsoft could provide them with no more support than a small OEM in East Asia that installs Windows on none of its PCs. Even without regard to the fairness and reasonableness of such decisions, decisions concerning the allocation of finite resources are what every business, regardless of its size, legitimately must make. It renders the word “retaliation” meaningless to suggest that such legitimate decisions would be proscribed by an “anti-retaliation” provision. However, the fact that Microsoft’s competitors would even make such a suggestion indicates why the company negotiated for, and why the Department and settling states agreed to, the clarification.

- Q4. *Microsoft is given 12 months to come into compliance with this proposed settlement; what tasks must it actually undertake that will require so much time?*
- A. The Revised Proposed Final Judgment does not become binding and the court’s powers of enforcement do not pertain until the court enters the judgment (hence the Department’s concern, as we understand it, that the Tunney Act proceeding not be delayed). Nevertheless, Microsoft has stipulated that it will abide by the terms of the Revised Proposed Final Judgment from the date it was submitted to the court for approval. The stipulation did give Microsoft until December 16, 2001, to begin its voluntary compliance with the Revised Proposed Final



Judgment; however, with the exception of three substantive provisions of the Revised Proposed Final Judgment which require substantial engineering work, Microsoft is currently complying with the provisions of the decree. With the exception of the creation of the Technical Committee (§ IV.B) and the term of the Revised Proposed Final Judgment (i.e., when it will expire) (the timing of both is measured from the date the decree is entered by the court), the clock begins to run on Microsoft's obligation to implement the provisions of the Revised Proposed Final Judgment on the date it was submitted to the court (i.e., November 6, 2001).

With respect to the three substantive sections that have not yet become effective, namely sections III.D, III.E, and III.H, all three require Microsoft to engage in substantial engineering work. That work is currently well underway.

In order to comply with section III.D., which requires Microsoft to disclose APIs and related Documentation used by Microsoft Middleware to interoperate with Windows 2000 or Windows XP (and subsequent versions of PC operating systems), Microsoft must do substantial work to identify the relevant interfaces, determine whether they have already been disclosed and, if not, develop the necessary documentation so third parties will understand what functions they perform and how to use them. Microsoft must disclose the APIs and documentation when it releases the first Service Pack for Windows XP. Microsoft may also be required to reengineer Microsoft Middleware, as well as Windows 2000 and Windows XP in order to comply with III.D. Because Microsoft has strong commercial incentives to issue the first Service Pack of a new operating system as soon as possible and delay of its issuance (and thus delay of the obligation to disclose APIs) will be costly to Microsoft, the Revised Proposed Final Judgment provides a strong incentive for Microsoft expeditiously to complete the necessary engineering work in order to comply with III.D by in effect holding up the release of the Windows XP Service Pack until disclosure of the relevant APIs and documentation under III.D is completed.

In the case of the "Add/Remove" utility and "defaults" that Microsoft must design and make available to end-users and OEMs under section III.H, significant changes to Windows XP and Windows 2000 must be engineered and made available in subsequent versions of the operating systems. Providing the ship date of the first service pack of Windows XP as the deadline for that work similarly provides a strong incentive to Microsoft to complete the necessary engineering work expeditiously.

In the case of both III.D and III.H, the expectation is that they will become effective well before November 6 of this year (i.e., twelve months after submission of the Revised Proposed Final Judgment to the court). At the time the decree was being negotiated, the company was planning to try to release the first service pack for Windows XP (a major engineering undertaking in itself) by the middle of this year. While Microsoft hopes that timing will not slip significantly,

a very substantial engineering burden was imposed on Microsoft by the decree and Microsoft advised the Department and the Plaintiff states of that fact during the negotiations. As a result the twelve months was put in as a "back stop" to provide the Department and the settling states with an absolute drop dead date for compliance with those two provisions. Everyone expects the first service pack of Windows XP to be released well in advance of November 2002.

Section III.E requires Microsoft to identify, document, and make available for third-party licensing Communications Protocols that allow a Windows server operating system to interoperate natively with Windows 2000 or Windows XP. As explained in my statement to the Committee, the so-called "client-server interop" issue is outside the scope of the Court of Appeals decision, but based on Microsoft's expectation that the Plaintiff states would settle if section III.E were included in the proposed relief, Microsoft reluctantly agreed to it. However, the provision requires Microsoft to license proprietary information that as a general matter Microsoft previously did not license to third parties. Again, it is a significant undertaking to inventory all the protocols, to develop the documentation for third parties, and otherwise to do the work necessary to license the protocols to third parties. In recognition of the scope of that work, the Revised Proposed Final Judgment provides Microsoft with nine months to accomplish the work (which unlike sections III.D and III.H, is not related to the work being done to develop the first service pack of Windows XP). Thus, starting on August 6, 2002, the relevant Communications Protocols will for the first time be available for third-party licensing.

- Q5. *The proposed settlement agreement provides that Microsoft's disclosure of APIs and documentation for an updated version of Windows in a "timely manner", and "timely manner" seems to be defined as the time at which Microsoft makes the new Windows version available to 150,000 or more beta testers. Does Microsoft routinely send beta test versions to so many testers? When has it done so in the past? Can't Microsoft avoid the disclose provision by simply limiting the number of beta testers?*
- A. In negotiating the decree, both sides understood the need for setting the obligation to disclose APIs and documentation sufficiently late in the development cycle of new products so that Microsoft is able to develop, test, and modify the APIs as well as the documentation of the APIs based on feedback the company gets from third-party testers included in early beta releases. Once the APIs and documentation are "disclosed" under section III.D, they need to be "hardened" or fixed because at that point third parties, particularly middleware vendors, will be writing their own software that calls on those APIs and will be frustrated and may be put to added expense if the APIs are modified significantly before the wide commercial release of the Microsoft platform product. On the other hand, the United States and the settling states insisted that the disclosure occur before the commercial release of the product so that third parties can begin designing products that take advantage of the APIs at the time or shortly after the time the

Windows PC operating system containing the APIs or the Microsoft Middleware is released commercially. In the case of Windows PC operating systems, historically the last major beta release before commercial release has involved substantially in excess of 150,000 beta testers; for example, the last major beta release of Windows XP was distributed to more than 500,000 beta testers.

It is inconceivable that Microsoft would forego beta testing or would limit the number of beta testers of a Windows PC operating system in order to avoid section III.D. Quite apart from the seriousness with which Microsoft takes its responsibilities under court orders, a failure by Microsoft to subject its products to extensive beta testing would threaten to exact a heavy toll on Microsoft's goodwill. Without extensive beta testing, Microsoft would significantly increase the risk of shipping products with major bugs that would engender consumer ill will. It is simply not credible for Microsoft's competitors to assert that Microsoft would subject its business to such a threat and raise questions about its compliance with the decree in order to achieve a temporary "head-start" over competing middleware vendors. The Committee should keep in mind that nowhere in its decision did the Court of Appeals affirm a finding that Microsoft *ever* failed to disclose APIs or otherwise manipulated disclosure of APIs to give Microsoft middleware an illegal advantage over the competition. Moreover, case law suggests that a monopolist is fully entitled to gain the competitive advantage of its own research and development work by not releasing information about it that might be needed by developers of competing products until after the public release of the company's new products.

- Q6. *If a PC manufacturer decides that it would like to remove Windows Moviemaker, is that action protected from the ban on retaliation in the proposed settlement? If a representative of a PC manufacturer or a software developer testified before this Committee or before the district court in the on-going states' case, would the settlement ban retaliation against them?*
- A. Windows Moviemaker is not in the list of Microsoft Middleware Products, nor should it be in light of the Court of Appeals decision. While the United States and the settling states insisted on a very broad (Microsoft believes, an overly broad) definition of "middleware," only a definition that essentially included all PC software would suffice to include features of Windows PC operating systems such as Windows Moviemaker and third-party software that performs similar functionality. The theory of the government's case and the rationale of the Court of Appeals decision is that Microsoft took certain actions (the twelve that the Court of Appeals affirmed) which were designed to exclude Netscape Navigator and Sun's Java technology from the market because separately or together they represented threats to Microsoft's position in the market for PC operating systems. That analysis had plausibility because the Court of Appeals concluded that, by exposing a broad range of general purpose APIs that developers could use to create applications and by having the capability of running on multiple PC operating systems, Navigator and Java had the potential to serve as platforms that

could compete with the Windows platform. By contrast, software for displaying and editing movies does not serve as a platform for applications development.

Moreover, the issue of Microsoft's unwillingness to allow OEMs to remove access to the Internet Explorer functionality was only anticompetitive because the Court of Appeals accepted the district court's finding that it impaired Netscape's ability to persuade OEMs to install and ship Navigator on their PCs. The government did not challenge and the Court of Appeals did not conclude that, by itself, Microsoft's practice of continually incorporating new features and functionalities in successive versions of Windows PC operating systems and insisting that OEMs install and ship Windows with its features and functionalities intact violated the antitrust laws. To the contrary, even under the previous Administration the Department has recognized, as did the Court of Appeals' opinion, that such integration in general is potentially beneficial to software developers who take advantage of the new APIs and consumers. (That insight is what led the Court of Appeals to hold that allegations that software integration amounts to an illegal tie-in must be analyzed under the Rule of Reason and, on that basis, to reverse Judge Jackson's conclusion that the integration of IE into Windows 98 was per se unlawful.)

Against this background, it should be no surprise that the Revised Proposed Final Judgment is silent concerning Microsoft's licensing policies with respect to the ability of OEMs to remove non-middleware features of Windows such as Windows Moviemaker. Indeed, any effort to include in this decree a provision that precluded Microsoft from integrating new features and functionality into Windows and ensuring that end users get all the features and functionalities of Windows, at least other than Microsoft middleware, would be directly contrary to the holding of the Court of Appeals. Microsoft does in its licenses with OEMs require them to ship Windows with all its non-middleware features intact. (OEMs, however, are free to *add* third party software of any kind, including digital media manipulation applications to computers before they ship, and many do.) An OEM that removed Windows Moviemaker before shipping Windows XP on its PCs would be in violation of its license agreement. As explained in response to question 3 above, legitimately seeking to enforce a valid license or contractual provision that does not violate the Revised Proposed Final Judgment would not be "retaliation" in any conventional sense of that word.

As for the question concerning the possibility of Microsoft retaliating against those who have testified against Microsoft, there is absolutely no basis for suspecting that Microsoft would even consider doing such a thing. Certainly the potential for such retaliation was not part of the plaintiffs' case and formed no part of the decision of the Court of Appeals. Nevertheless, the Revised Proposed Final Judgment makes clear (sections III.A.3 and III.F.1.b) that Microsoft cannot retaliate against any OEM, ISV or IHV, including those who testified against Microsoft, because that third party chooses to exercise any of the options provided by the Revised Proposed Final Judgment.

Q7. *Software developers that take advantage of the middleware API disclosure are required by the proposed settlement to cross-license their products back to Microsoft. Presumably this is of great benefit to Microsoft, but how does it fit into remedying the antitrust violations found in court?*

A. Nothing in the Revised Proposed Final Judgment requires software developers to license their products to Microsoft, whether or not the developers choose to use the new middleware APIs that Microsoft is obligated to disclose.

Paragraph III.I. requires Microsoft to license to certain third parties any Microsoft intellectual property that is necessary for them to exercise the options and alternatives provided under the Revised Proposed Final Judgment. Subpart 5 states that those parties “may be required” to license to Microsoft any intellectual property they may have relating to the exercise of such options or alternatives on “reasonable and nondiscriminatory terms” so that Microsoft can comply with the Revised Proposed Final Judgment by offering those options and alternatives to those parties without running afoul of intellectual property law. This provision simply facilitates implementation of the decree provisions.

Q8. *The provision of the proposed settlement addressing the availability of server communications protocols refers to protocols that are “used to interoperate natively, i.e., without the addition of software code to the client operating system product, with a Microsoft server operating system product.” I am confused about the meaning of “natively,” and the Competitive Impact Statement does not clarify it. As the issue of Microsoft’s possible abuses in the server arena are even now before the European Union’s antitrust enforcement branch, I am interested to know precisely what your proposal accomplishes, and whether it addresses the EU’s concerns as well?*

A. The “client-server interoperability” provision (section III.E) is one example where the Revised Proposed Final Judgment addresses an issue that has nothing to do with the Court of Appeals’ decision. Microsoft agreed to that provision in order to settle this case and move forward in a positive posture with the federal and state governments. In particular, Microsoft agreed to the provision based on its expectation that if it did the states would agree to the Revised Proposed Final Judgment. Section III.E. requires Microsoft to disclose Communications Protocols used by Windows to interoperate with Microsoft server operating systems. The term “natively” means that the interoperation is directly between a Windows PC operating system such as Windows XP and a Microsoft server operating system product as opposed to communications between a Microsoft server and a program running on top of such PC operating systems. As Microsoft understood the concern that the provision was designed to address, the plaintiffs wanted to prevent Microsoft from leveraging its position in PC operating systems to harm competition in server operating systems. I have not consulted with the EU on either the Revised Proposed Final Judgment or its investigation, and so

cannot represent whether or not this provision addresses any concerns the EU may have.

Q9. *The proposed settlement's prohibition on retaliation against software developers creates an exception from that prohibition for agreements that "are reasonably necessary to and of reasonable scope and duration" in connection with obliging a developer to use, distribute, promote, or develop software for Microsoft. What do you envision that exception to cover, and more importantly, what does it leave within the ban against retaliation?*

A. This question seems to reflect a misreading of section III.F of the Revised Proposed Final Judgment. The "exception" for reasonably ancillary contractual limitations applies to subsection III.F.2 (which prohibits Microsoft from conditioning the grant of consideration on an ISV's refraining from developing, etc., any competing software) rather than to the "anti-retaliation" prohibition of III.F.1. In response to question 3, I have explained that the anti-retaliation provisions of the Revised Proposed Final Judgment contain no "carve-outs" or "exceptions."

The exception language in section III.F.2 simply makes clear that Microsoft may engage in the routine business practice of collaborating with third parties that wish to use, distribute or promote Microsoft software or to develop software together with Microsoft. To the extent that Microsoft enters into such agreements, it may place limitations on the third parties if the limitations are carefully tailored and reasonably necessary in relation to the bona fide contractual arrangement between Microsoft and the third party. The law has long recognized that legitimate ancillary restraints are often critical to procompetitive collaborations, and this exception simply reflects that recognition. There is nothing in the Court of Appeals decision or in public policy to suggest that such an exception is inappropriate. Indeed, in the absence of this provision, Microsoft would be reluctant or unable to enter into many procompetitive collaborations -- a result that would restrict opportunities for third parties and potential benefits for consumers.

Q10. *The proposed settlement permits the removal of the Internet Explorer icon, but as I understand it, even if a user chooses to remove Internet Explorer, IE will continue to pop up in MyDocuments, MyMusic, and MyPictures. Is this understanding correct, and if so, how can a user ever be free of Internet Explorer?*

A. The creation of default opportunities for third-party middleware (section III.H.2) is another area where the Revised Proposed Final Judgment actually goes beyond the decision of the Court of Appeals. The whole concept of "defaults" is a reflection of how Microsoft historically has chosen to design its operating systems to provide extensive opportunities for non-Microsoft software, even when that software duplicates functions already provided by Windows. Generally,

operating systems (Microsoft's as well as those of its competitors) are a set of integrated functionalities and are designed to rely on and invoke those internal functionalities to perform various tasks. So for example, when the end user asks Windows to perform a task that requires displaying information in HTML (the format of the Web), Windows invokes its internal HTML display software, which is Internet Explorer. (And, of course, by utilizing the Windows API set, ISVs can also invoke the Windows HTML display software). Over time, the designers of Windows have chosen to give ISVs the opportunity to take over certain functions -- typically to open and display certain file types (e.g., .htm files) -- in circumstances in which the designer believes will enhance the end-user experience. On the other hand, if allowing a third party to take over a function would disrupt the integrated experience for an end user, Windows generally does not provide a third-party default opportunity.

In the case against Microsoft, the Department and the Plaintiff states alleged that Microsoft's design of Windows to "override" the OEMs' or end-users' choice of a default browser in certain circumstances (for example, in the case of Windows Help and Windows Explorer) amounted to illegal monopoly maintenance. (As explained above, it is more accurate to say that Microsoft in designing Windows chose not to create a default opportunity with respect to certain aspects of Windows where an integrated experience seemed more appropriate.) While the plaintiffs prevailed on this point in the district court, this was one of those aspects of the district court's decision that the Court of Appeals expressly reversed. *United States v. Microsoft*, 253 F.3d 34, 67 (D.C.Cir. 2001). The Court of Appeals ruled that "Microsoft may not be held liable for this aspect of its product design."

Notwithstanding this clear Microsoft victory, the United States and the settling states insisted that Microsoft be required to design future versions of its Windows PC operating systems in such a way as to guarantee OEMs and third-party vendors of middleware default opportunities in those circumstances described in section III.H.2. Those opportunities apply not just to Internet browsing software but to any third party software that meets the definition of middleware. To some extent that may require Microsoft to design the operating system in a way that allows third-party middleware to interject itself in ways that disrupt the integrated end-user experience; however, Microsoft agreed to III.H.2, despite the absence of a basis for it in the Court of Appeals decision, in order to settle the case.

- Q11. *In 1995, the Department and Microsoft entered into a Consent Decree. Two years later, the Department sued Microsoft for contempt of the Decree when Microsoft and the Department disagreed over the meaning and correct interpretation of certain provisions of the Decree, including the meaning of the word "integrate" as that term was used in the Decree. Given the prior litigation between the Department and Microsoft over the proper interpretation of the 1995 Consent Decree, do you agree that Microsoft and the Department should have a*

*common, explicit understanding of the meaning and scope of this proposed Final Judgment before it is entered?*

- A. The Department and Microsoft entered into their first consent decree in 1994, and Microsoft began its compliance immediately. The decree was not approved by the court until 1995. The Department and Microsoft had a common understanding of that decree, but over time the Department personnel involved in the negotiations left the Department and new personnel instituted the litigation in 1997. In 1998, the Court of Appeals confirmed that Microsoft's interpretation of the decree was likely correct, and that Microsoft had not violated the decree.

It is important that Microsoft and the Department have a common understanding of the Revised Proposed Final Judgment to avoid unnecessary litigation in the future. Microsoft is confident that the extensive negotiations in this case have resulted in a clear agreement between the parties involved. Indeed, a great deal of the mediation process was devoted to developing technical concepts and clear language to ensure that there was a clear meeting of the minds concerning Microsoft's obligations under the decree. While Judge Jackson's now-vacated June 2000 judgment may seem clear to a non-technical lawyer, it is largely technical "gibberish," and the reasons for many of the changes in the language in analogous provisions of the Revised Proposed Final Judgment were to make the provisions meaningful and to avoid the sorts of disputes about which you speak.

Because the software design and disclosure issues addressed by the Revised Proposed Final Judgment are inherently complex and technical (far more so than any other antitrust decree of which I am aware), it is no surprise that the language of the Revised Proposed Final Judgment would seem complex. However, the language of the Revised Proposed Final Judgment is infinitely clearer and less ambiguous than that of Judge Jackson's order (or the proposed remedies of the non-settling states), and thus infinitely less likely to engender never-ending disputes between the United States and Microsoft. Moreover, the Technical Committee is designed to ensure prompt resolution of any issues that may arise over the application of the technical language to specific factual circumstances.

- Q12. *Do you agree that the meaning and scope of the proposed Final Judgment as agreed upon by the Department and Microsoft should be precise, unambiguous and fully articulated so that the public at large can understand and rely on your mutual understanding of the Judgment?*
- A. Yes, that is an important goal; however, the ultimate test is whether the language is understood and meaningful to the parties and to the courts which must interpret it. Given the government's objective of imposing prohibitions and obligations concerning Microsoft's design of the Windows PC operating system and Microsoft middleware, it was essential, as explained in response to question 11, that the Revised Proposed Final Judgment use technical terms that may be foreign to the lexicon of most members of the public. Any effort to make the language



easily understood to those unskilled or unfamiliar with software technology would be a prescription for enforcement disaster. Given the inherently complex and technical subject matter of the Revised Proposed Final Judgment, I am convinced that the language is as "precise, unambiguous and fully articulated" as is possible. A knowing comparison to the language in Judge Jackson's judgment or the proposed remedies of the non-settling states makes clear how vastly better a job the Revised Proposed Final Judgment does in providing a precise, meaningful, and enforceable set of provisions than either of those alternatives.

Q13. *If Microsoft and the Department were to disagree about the correct interpretation of one or more important provisions of the proposed Final Judgment, would you consider that to be a potentially serious problem?*

A. There is no one who wants to avoid disputes over the correct interpretation of the decree more than Microsoft. Even though Microsoft was ultimately vindicated in its interpretation of the 1995 decree when a dispute arose between Microsoft and the Department, the process of obtaining that vindication was very painful and costly to the company. One of Microsoft's principal goals in the negotiations that led to the Revised Proposed Final Judgment was to develop concepts and language on which Microsoft and the plaintiffs had a clear meeting of the minds and which could be understood and fully complied with by the company and its thousands of employees. As explained in response to earlier questions, measured by that standard, the Revised Proposed Final Judgment does a vastly better job than any of the alternatives of which I am aware.

Q14. *Do you agree that it would be highly desirable to identify any significant disagreement between Microsoft and the Department over the correct interpretation of the proposed Final Judgment now, before the Judgment is entered by the Court, rather than through protracted litigation as in the case of the 1995 Consent Decree?*

A. While it is certainly preferable to identify disagreements before rather than after the Revised Proposed Final Judgment is entered, we spent countless hours negotiating this agreement with the Department and the states with the help of court-appointed mediators, and are confident that we have a clear agreement. As I explained in response to the previous questions, one of Microsoft's principal objectives in the negotiation was to develop a decree that would avoid the sort of litigation, which Microsoft ultimately won, that arose out of the 1995 Consent Decree. (I should also note that the 1997 litigation was resolved by the Court of Appeals, in Microsoft's favor, within nine months of the Department's petition for relief.) It was imperative that we have a decree with a clear meaning to both the Department and Microsoft that would retain its clarity even as the personnel in the Department changes. That said, it is probably impossible to craft language that is so clear that disputes over its meaning are inconceivable. However, while I would not contend that the negotiations achieved perfection, the Revised Proposed Final Judgment is significantly less prone to dispute than the

alternatives, such as Judge Jackson's now-vacated June 2000 judgment or the non-settling states' proposed relief. Moreover, to the extent legitimate disputes do arise in the future that cannot be resolved by other means, the courts remain our society's best vehicle for resolving such disputes.

Q15. *Can the public at large rely upon the Department's Competitive Impact Statement as the definitive interpretation of the nature and scope of Microsoft's obligations under the Final Judgment? If not, then what is the mutually understood and agreed-upon interpretation of the meaning and scope of Microsoft's obligations under the Final Judgment?*

A. The Competitive Impact Statement was prepared pursuant to the Department's obligations under the Tunney Act. It has the same legal force that the Tunney Act gives any Competitive Impact Statement.

Q16. *Does the Competitive Impact Statement accurately reflect Microsoft's interpretation of the proposed Final Judgment?*

A. Microsoft did not participate in the preparation of the Competitive Impact Statement. The language of the Revised Proposed Final Judgment was carefully negotiated and means what it says. The Department's Competitive Impact Statement has the same legal force and effect in this case as in any other. Beyond that I cannot go in light of the facts that the Tunney Act proceeding is currently under way before Judge Kollar-Kotelly and that the non-settling states are attempting to raise various issues concerning the Competitive Impact Statement as part of the ongoing "remedies" litigation also before Judge Kollar-Kotelly. Once that litigation is completed, I may be in a better position to discuss these issues with the Committee.

Q17. *Recognizing that the Department's Competitive Impact Statement cannot address every conceivable issue that may arise in the future concerning the proposed Final Judgment, is there anything stated in the Competitive Impact Statement with which Microsoft disagrees?*

A. See the answer to question 16.

Q18. *Has Microsoft informed the Department that it has any disagreement with the Department's interpretation of the Final Judgment as set forth in the Competitive Impact Statement?*

A. See the answer to question 16.

Q19. *Does Microsoft disagree with anything stated in the Department's Competitive Impact Statement concerning the meaning and scope of the proposed Final Judgment?*

A. See the answer to question 16.

Q20. *Will you commit on behalf of Microsoft to inform this Committee in writing of each and every statement in the Department's Competitive Impact Statement with which Microsoft disagrees? Will you commit to do so within the next 15 days so that the public can understand what disagreements Microsoft has with the Competitive Impact Statement before the Tunney Act comment period expires?*

A. See the answer to question 16.

Q21. *Was there anything in Assistant Attorney General James' testimony before this Committee concerning the meaning and interpretation of the proposed Final Judgment with which Microsoft disagrees?*

A. I thought the testimony of AAG James accurately described the Revised Proposed Final Judgment, and nothing I have seen or heard since November 6th leads me to change my view that the Revised Proposed Final Judgment reflects a clear meeting of the minds between Microsoft on the one hand and the Department and the settling states on the other.

Q22. *The Department's Competitive Impact Statement states at page 38 that: "if a Windows Operating System Product is using all the Communications Protocols that it contains to communicate with two servers, one of which is a Microsoft server and one of which is a competing server that has licensed and fully implemented all the Communications Protocols, the Windows Operating System Product should behave identically in its interaction with both the Microsoft and non-Microsoft servers." Does Microsoft agree that this accurately states one objective of Microsoft's obligations under section III(E) of the proposed Final Judgment?*

A. See the answer to question 16.

Q23. *The Department's Competitive Impact Statement states at page 36 that: "Section III.E. will prevent Microsoft from incorporating into its Windows Operating System Products features or functionality with which its own server software can interoperate, and then refusing to make available information about those features that non-Microsoft servers need in order to have the same opportunities to interoperate with the Windows Operating System Product." Does Microsoft agree that this accurately states one objective of Microsoft's obligations under section III(E) of the proposed Final Judgment?*

A. See the answer to question 16.

Q24. *The Department's Competitive Impact Statement states at page 37-37 that: "Because the Communications Protocols must be licensed 'for use' by third parties, the licensing necessarily must be accompanied by sufficient disclosure to*

*allow licensees fully to utilize all the functionality of each Communications Protocol.” Does Microsoft agree that this accurately states one objective of Microsoft’s obligations under section III(E) of the proposed Final Judgment?*

- A. See the answer to question 16.

**Hatch Questions.**

- Q1. *Concerns have been voiced about potential “loopholes” that might be created by ambiguities in various definitions that are fundamental to determining Microsoft’s responsibilities under the settlement. Do you agree that the “Competitive Impact Statement” accurately memorializes the spirit and underlying considerations of the Proposed Settlement agreement; and do you further agree that it should be used as an authoritative interpretive guide in settling disputes about the practical application of the Proposed Settlement?*

- A. The Competitive Impact Statement was prepared pursuant to the Department’s obligations under the Tunney Act. It has the same legal force that the Tunney Act gives any Competitive Impact Statement.

Ultimately, the language of the Revised Proposed Final Judgment controls. Contrary to the assumption in the question that the proposed judgment is full of loopholes, it is not. Both sides spent five weeks full time working out technically complex concepts and reducing them to language that both sides agreed to and understood. Both sides worked long hours on crafting the precise wording of the Revised Proposed Final Judgment, and while the language is technical and somewhat complex, reflecting the subject matter of the judgment, it is vastly clearer, more precise, and understandable to those bound by the decree and to those who must enforce it than any of the alternatives ever suggested, including Judge Jackson’s now-vacated June 2000 order and the relief proposed by the non-settling states.

- Q2. *Could you please identify the specific aspects of the Competitive Impact Statement that you believe do not accurately represent Microsoft’s understanding of the Proposed Settlement? And, to the extent you believe that the Competitive Impact Statement is inaccurate, would Microsoft be willing to provide a detailed description of these perceived inaccuracies along with specific language describing Microsoft’s understanding of the issue, language, or provision, the accuracy of which Microsoft disputes?*

- A. Microsoft did not participate in the preparation of the Competitive Impact Statement. The language of the Revised Proposed Final Judgment was carefully negotiated and means what it says. The Department’s Competitive Impact Statement has the same legal force and effect in this case as in any other. Beyond that I cannot go in light of the facts that the Tunney Act proceeding is currently under way before Judge Kollar-Kotelly and that the non-settling states are

attempting to raise various issues concerning the Competitive Impact Statement as part of the ongoing "remedies" litigation also before Judge Kollar-Kotelly. Once that litigation is completed, I may be in a better position to discuss these issues with the Committee.

- Q3. *In your written testimony (p. 9) you briefly address the Proposed Settlement's prohibition of retaliation by Microsoft against computer makers. You summarize the provision in the settlement stating that "Microsoft has agreed not to retaliate against computer makers who ship software that competes with anything in [Microsoft's] Windows operating system." Id. Concerns, however, have been raised regarding perceived limitations on this anti-retaliation provision. Could you explain either why the perceived caveats were included in the anti-retaliation provision as well as why you believe that these perceived caveats do not **actually** allow Microsoft to engage in substantial retaliation against computer makers?*
- A. The Revised Proposed Final Judgment makes clear that Microsoft may not retaliate against OEMs, ISVs, and IHVs because they develop, etc., software that competes with the Windows PC operating systems or Microsoft Middleware. The provision prohibits "retaliation" as that word is commonly understood and defined. The provisos in the relevant sections of the Revised Proposed Final Judgment do not provide opportunities for Microsoft to circumvent this prohibition; rather, those provisos simply provide some certainty that in the future no one will try to extend the prohibition to certain conduct that is legitimate and not generally understood to be "retaliation." So for example, the Revised Proposed Final Judgment is written to ensure that it will not be possible to twist the common meaning of "retaliation" to cover situations in which Microsoft seeks legitimately to protect its intellectual property against infringement. The decree also makes clear that Microsoft may enforce a contract, including through rights of termination against an OEM that has breached the contract by, for example, refusing to pay royalties due and owing to Microsoft. Microsoft's ability to enforce valid OEM agreements that do not violate the decree is qualified, however, because section III.A requires Microsoft to give an OEM the opportunity to cure any breach at least two times during the term of the contract (which currently is one year).
- Q4. *Is it your position that the anti-retaliation provision does in fact prohibit Microsoft from all forms of retaliation against computer software makers that choose to ship software that competes with Microsoft products; and, if not, how do you answer the criticisms that the provision is insufficient to effectively prevent retaliation?*
- A. See the answer to question 3.
- Q5. *Several media sources and commentators have reported that major computer makers – or "OEMs" – such as Hewlett Packard, Compaq, Dell, and Gateway, are heavily dependent on Microsoft, which – some have argued – may explain the*

*lack of vocal opposition by these companies to the Proposed Settlement. With this in mind, how can the Proposed Settlement's substantial reliance on these companies to incorporate software that competes with Microsoft products on the computers they distribute be trusted to result in actual competition in the middleware market?*

- A. The Department and the plaintiff states are probably in the best position to explain the theory of their case and their request for relief. Nevertheless, both the premise of much of the case and of much of the relief proposed by anyone in this case has been that competition will be enhanced if Microsoft is prevented from retaliating against or favoring OEMs on the basis of their decisions whether or not to distribute, support, etc., software that competes with Microsoft's PC operating systems or middleware. The United States and settling states insisted on sections III.A and III.B to eliminate Microsoft's ability to harm or favor OEMs based on their decisions to support, *vel non*, software that competes with Microsoft platform software. In addition, section III.C ensures OEMs that they will have freedom to install and feature non-Microsoft middleware, and section III.H even obligates Microsoft to design its future operating systems in ways that make it easier for OEMs (and end users) to display non-Microsoft middleware.

The Revised Proposed Final Judgment thus eliminates what the United States and Plaintiff states perceived as disincentives for OEMs to install and feature non-Microsoft PC operating systems and middleware, and the proposed judgment creates a number of new incentives and opportunities for OEMs to install and feature such software. It is noteworthy that even before these new protections for OEMs were put in place, OEMs were shipping non-Microsoft software, like the AOL client or RealNetworks media software, that fits within the Revised Proposed Final Judgment's broad definition of middleware. Indeed, AOL currently has a major advertising campaign with broadcast commercials advising PC owners that "AOL is already installed on most computers, probably even yours." It is also worth noting that the Court of Appeals did not conclude that Microsoft "retaliated" against any OEM for shipping any competing software.

- Q6. *Could you please explain, in detail, what incentives you believe will actually lead OEMs to install software that competes against Microsoft software? Are you aware of particular competing software that OEMs might currently wish to install in favor of similar Microsoft products?*

- A. As explained in response to question 5, OEMs are already shipping a lot of non-Microsoft middleware. If there is any doubt, I invite anyone to visit their local PC retailer and discover all the preloaded non-Microsoft software that OEMs are already offering on the PCs they ship. The AOL and RealNetworks examples in the response to question 5 are not alone. The Revised Proposed Final Judgment provides OEMs with flexibility to hide access to certain features in Windows if those OEMs wish to promote non-Microsoft software in lieu of the Windows features. As explained in my answer to other questions from the Committee, the

Court of Appeals upheld the district court's finding that OEMs were less likely to install non-Microsoft Web browsing software if they were not allowed to hide the icons for Internet Explorer. OEMs will now be free to do so for Web browsing and other categories of software. Whether OEMs really wish to hide access to features of Windows, of course, remains to be seen. Nevertheless, the important point is that the Revised Proposed Final Judgment removes any obstacle posited by the plaintiffs in the case and provides significant new opportunities for installing non-Microsoft middleware products on PCs running Windows.

Q7. *With respect to concerns raised regarding the lack of a strong enforcement mechanism in the Proposed Settlement, could you please expand upon the reason that you believe the Proposed Settlement ensures effective enforcement? Could you also explain your view of how enforcement will occur? Finally, could you explain why – assuming that this is your position – the proposed alternative enforcement mechanisms are either unnecessary, undesirable, or both?*

A. As stated in my testimony, the enforcement provisions in the Revised Proposed Final Judgment are unprecedented in a civil antitrust decree. While enforcement authority resides with the Department and the settling states (as parties to the settlement), the Revised Proposed Final Judgment puts an independent Technical Committee on the Microsoft campus with broad authority and unlimited access to company facilities, personnel and intellectual property – including the most sensitive of Microsoft's proprietary software code. The Technical Committee is intended to help monitor and resolve any technical issues that arise in an expeditious and expert manner without putting Microsoft's legitimate intellectual property rights at risk of confiscation. As for interpreting the legal meaning of the Revised Proposed Final Judgment and expertly and effectively utilizing enforcement mechanisms to ensure that the judgment is complied with, the Department of Justice and the states quite understandably felt that there is no one in the world with their experience in interpreting and enforcing antitrust decrees. As a consequence they negotiated for and obtained, a complete set of the enforcement powers that the Department historically has obtained in antitrust judgments. Moreover, they demanded and obtained judgment provisions that ensure that the Technical Committee will not in any way undermine or abrogate those powers.

All of the alternative enforcement mechanisms that have been proposed by third parties would really add nothing to the power of the Department and the states to enforce a judgment. If anything they would add layers of bureaucracy and potentially undermine the Department's control over enforcement of the decree. For example, some have suggested the need for a special master. No one argues that a master is a substitute for the Technical Committee; rather, the master would be a complement to deal with legal issues. The Department, however, does not need help dealing with legal issues surrounding consent decrees; it is the nation's leading expert on such issues. Moreover, because the master could not assume Article III powers, Microsoft would be able to appeal any decision to the district

court and beyond, thereby delaying final resolution of disputes. On the other hand, a master could interfere with the legitimate and routine exercise of the Department's constitutionally based prosecutorial discretion.

### DeWine Questions

- Q1. *Mr. Rule, in your testimony you have gone to great length to explain how certain portions of the government's case were dropped or thrown out during the course of litigation. Does Microsoft acknowledge that it violated the antitrust laws?*
- A. Microsoft certainly acknowledges that the Court of Appeals held that certain of Microsoft's conduct amounted to monopoly maintenance in violation of section 2 of the Sherman Act. The reason that Microsoft went so far in the negotiations with the Department of Justice and the states -- as my testimony explained, the Revised Proposed Final Judgment covers conduct and products that were never part of the case -- was to close this contentious chapter in the company's history and move forward in a new, more constructive manner with the Department and the states. Unfortunately, several of the states that had less involvement in the litigation and negotiations than the states that settled decided to hold out for relief that not only has nothing to do with the Court of Appeals decision but is also confiscatory, anticompetitive, and in many cases unintelligible. As a result, Microsoft has had no choice but to continue litigation and must preserve its full ability to defend itself, including its right if necessary to seek review of the Court of Appeals' decision.
- Q2. *Mr. Rule, many within the high tech industry have argued that the antitrust laws are overly cumbersome when it comes to promoting competition within the fast-changing industry. Is this Microsoft's position?*
- A. No, Microsoft recognizes that the antitrust laws have an important role in protecting the benefits of competition in all industries, including high technology.
- Q3. *Mr. Rule, What do you believe are the appropriate objectives of remedies in monopolization cases such as this? Do you believe the case law supports a position that monopoly acquisition cases should be treated differently than monopoly maintenance cases? Finally, do you believe this settlement fully achieves the appropriate remedy objectives? If not, in what ways is it deficient? And in what ways, if any, do you believe it reaches beyond the case?*
- A. At pages 4 and 5 of my testimony to the Committee, I quoted the language of the Court of Appeals' decision and the comments of Judge Kollar-Kotelly concerning the scope of remedy. Moreover, in a recent article in the ABA's *Antitrust* magazine, Assistant Attorney General Charles James provides an analysis of the legal basis for relief in a case such as this. Also, it is worth recalling that the Court of Appeals quoted the antitrust treatise of Professors Areeda and Hovenkamp, to the effect that "[m]ere existence of an exclusionary act does not



itself justify full feasible relief against the monopolist to create maximum competition.’ . . . Absent such causation [i.e., between the conduct and creation or maintenance of monopoly power], the antitrust defendant’s unlawful behavior should be remedied by ‘an injunction against continuation of that conduct.’” *United States v. Microsoft Corp.*, 253 F.3d 34, 106 (D.C. Cir. 2001), *quoting* 3 AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 650a, at 67. Moreover, the court noted that “the District Court expressly did not adopt the position that Microsoft would have lost its position in the OS market but for its anticompetitive behavior.” 253 F.3d at 107. The court concluded its review by stating that any remedy “should be tailored to fit the wrong creating the occasion for the remedy.” *Id.* As this analysis suggests the case law does support the proposition that the remedial objectives are different in cases of monopoly acquisition as opposed to monopoly maintenance, particularly where, as here, the causal connection between the defendant’s position in the market and the illegal conduct is tenuous at best.

Evaluated against the backdrop of the relevant caselaw, the Revised Proposed Final Judgment goes substantially beyond what the law required for a remedy in this case. To cite just a few examples, the definition of middleware is much broader and more inclusive than the conception of middleware at issue in the Court of Appeals decision. Several of the central, most onerous provisions of the Revised Proposed Final Judgment involve conduct that was not even addressed by the Court of Appeals. For example, nothing in the Court of Appeals decision suggests that the way in which Microsoft has made APIs and related documentation available to third parties violated the Sherman Act; yet, Microsoft has agreed to a whole regime of compulsory API disclosures for middleware. Similarly, nothing in the decision even calls into question charging different OEMs different royalties for Windows licenses, but the Revised Proposed Final Judgment requires Microsoft to charge the top 20 OEMs uniform royalties. Nothing in the decision suggests that Microsoft ever has retaliated against any OEM, ISV or other company because it supported or shipped competing software; yet, Microsoft agreed to several provisions prohibiting such retaliation. And Microsoft is obligated to license its client-server communications protocols despite the fact that the so-called client-server interop issue was not raised in the District Court much less before the Court of Appeals. In contrast, I have yet to hear a credible argument as to how, in light of the Court of Appeals opinion, the Revised Proposed Final Judgment is deficient.

- Q4. *Some believe that unless Microsoft is prevented from commingling operating system code with middleware code, competitors will not be able to truly compete in the middleware market. Because the code is commingled, the Microsoft products cannot be removed even if consumers don’t want them. It seems to me that this deters competition in at least two respects. First, as the Appellate Court found, commingling deters computer manufacturers from pre-installing rival software. And second, it seems that software developers are more likely to write their programs to operate on Microsoft’s middleware if they know that the*

*Microsoft middleware will always be on the computer whereas competing products will not. Even if consumers are unaware that code is commingled, shouldn't we be concerned about the market impact of commingling code? What is the upside of allowing it to be commingled, and on the other hand, what concerns are raised by removing the code?*

- A. First, it is important to emphasize that the Revised Proposed Final Judgment does address the issue of commingling of code as that issue was relevant in the Department's case and the Court of Appeals opinion. The only objection to commingling advanced in the case was that it made it impossible for OEMs to remove end user access to Internet Explorer. Section III.H of the Revised Proposed Final Judgment obviates any such concern by requiring Microsoft to design its Windows PC operating systems in such a way as to enable OEMs and end users to remove end user access to Microsoft middleware and replace it with access to non-Microsoft middleware. Given the theory of the case, the record developed in the lower court, and the decision of the Court of Appeals, this provision of the Revised Proposed Final Judgment provides a complete remedy.

Second, as Assistant Attorney General James indicated in response to one of the questions of the Committee during the hearing, the plaintiffs never sought to prevent Microsoft from integrating functionality into its operating systems or from exposing that functionality through APIs to ISVs. Indeed, as I understand, even the Department's proposed divestiture remedy which was adopted by Judge Jackson, kept a single, intact operating system company so as to prevent "balkanization" of the Windows platform. Moreover, the Court of Appeals decision clearly recognized the benefits of integration in the area of platform software and the benefits of the ubiquity of the API set of Windows. The Court's discussion of "commingling" did not reflect hostility to ubiquitous dissemination of APIs. Any remedy that allowed OEMs to remove code and APIs from Windows would be unworkable: third party developers and their customers would suffer because their applications would not run properly, assuming they would run at all, if OEMs removed code exposing APIs. Indeed, it would make no sense to obligate Microsoft to disclose new APIs (as the Revised Proposed Final Judgment does) while at the same time allowing OEMs to create versions of Windows from which APIs are removed, rendering the disclosed APIs useless to developers.

- Q5. *Many believe that this settlement proposal merely requires Microsoft to stop engaging in illegal conduct, but does little in the way of denying Microsoft the benefits of its bad acts. First, how would you answer these critics? Is this just a built-in reality of civil antitrust remedies, that they don't really aim to punish? And second, do you believe the remedy here is strong enough to dissuade other potential monopolists from engaging in the type of conduct in which Microsoft engaged?*

- A. The Revised Proposed Final Judgment goes well beyond halting the specific acts found to violate the antitrust laws. It is true that the purpose of a civil antitrust decree is to remedy the violation rather than punish the offender, but the decree in this case provides very strong relief beyond the markets and practices at issue in the underlying case. This remedy will change the way Microsoft does business and is more than what the law requires. As both the trial court and the Court of Appeals recognized, the plaintiffs failed to prove that Microsoft benefited from any of its acts that were held to violate the Sherman Act, so no basis exists for requiring that Microsoft be denied any such benefits. Moreover, while it is well-established in the law that punishment and deterrence are not a proper objective of a consent decree in a civil antitrust case, there is no question that the cost to Microsoft of this litigation, the follow-on private, treble damage actions, and the far-ranging nature of the Revised Proposed Final Judgment send a powerful signal to Microsoft and other firms all across the economy.

### Kohl Questions

- Q1. *Mr. Rule, in the past your client Microsoft has been adamant in denying it was a monopolist – despite its 95% share of computer operating systems – and that it in any way violated the antitrust laws. Now, the unanimous D.C. Circuit Court of Appeals has ruled that Microsoft indeed is a monopolist and indeed acted illegally to maintain its monopoly. Will this ruling – and Microsoft’s experience in this litigation – in any way chasten Microsoft into behaving more responsibly? Is Microsoft now willing to recognize that it is a monopolist and, as a result, has obligations to deal with competing businesses in a way that would not exist if did not have monopoly power in its business?*
- A. Microsoft certainly acknowledges that the Court of Appeals held that Microsoft possesses monopoly power and that certain of Microsoft’s conduct amounted to monopoly maintenance in violation of section 2 of the Sherman Act. Moreover, the Revised Proposed Final Judgment represents Microsoft’s extensive concessions to relief that go far beyond what the company believes the Department and states had a right to obtain under the applicable precedents -- as my testimony explained, the Revised Proposed Final Judgment covers conduct and products that were never part of the case. The reason that Microsoft went so far in the negotiations with the Department of Justice and the states was to close this contentious chapter in the company’s history and move forward in a new, more constructive manner with the Department and the states. Unfortunately, several of the states that had less involvement in the litigation and negotiations than the states that settled decided to hold out for relief that not only has nothing to do with the Court of Appeals decision but is also confiscatory, anticompetitive, and in many cases unintelligible. As a result, Microsoft has had no choice but to continue litigation and must preserve its full ability to defend itself, including its right if necessary to seek review of the Court of Appeals’ decision.

Q2. *Please identify for us five specific ways in which the proposed settlement, once it is in force, will compel Microsoft to change its business practices in a manner which will benefit consumers.*

A. The Revised Proposed Final Judgment imposes a number of new obligations on Microsoft. As you have requested, the following is a list of five such changes chosen at random. First, section III.B requires Microsoft to provide the top 20 OEMs with uniform license agreements pursuant to terms and conditions. Pursuant to the stipulation Microsoft signed when the Revised Proposed Final Judgment was filed on November 6th, the new terms became effective on December 16th. Second, III.C requires Microsoft to allow OEMs to remove end user access to functionality in Windows XP such as Windows Media Player and Windows Messenger and to replace it with access to third-party software or services such as RealNetworks media player and to AOL's Instant Messenger. Third, section III.E requires Microsoft to license all of the communications protocols that Windows PC operating systems use to interoperate natively with Windows server operating systems. While Microsoft has licensed some of those protocols to third parties on an ad hoc basis, the company has never made them available systematically to third parties. Fourth, section III.G prohibits Microsoft from agreeing with a variety of third parties to contracts that require the third parties to distribute, promote, use, or support Microsoft platform software "in a fixed percentage" except in narrow circumstances. Prior to agreeing to the Revised Proposed Final Judgment, Microsoft sometimes used fixed percentage requirements to ensure that it received the effort from third-parties for which Microsoft bargained; Microsoft can no longer freely use this normal business mechanism. Fifth, section IV.B requires Microsoft to accept three neutral technical experts (the "Technical Committee") onto its campus and provide them with full access to its employees and its most confidential information. This is unprecedented not just for Microsoft but for any other U.S. firm of which I am aware. Presumably, the Department of Justice and settling states believed these changes (as well as the others in the Revised Proposed Final Judgment) would benefit consumers or they would not have demanded the inclusion of these provisions in the Revised Proposed Final Judgment.

Q3. *The proposed consent decree contains prohibitions on Microsoft retaliating against computer makers who choose to install in their machine software products that compete with software made by Microsoft. But many wonder if Microsoft will be able to offer financial incentives to accomplish essentially the same thing. For example, could Microsoft offer to pay incentive amounts to computer makers who feature or promote Microsoft software on their machines?*

A. Section III.C of the Revised Proposed Final Judgment prohibits Microsoft from restricting OEMs by agreement from, among other things, installing any non-Microsoft middleware on the PCs that the OEM ships. That section also prohibits Microsoft from "restrict[ing] by agreement" any OEM from "[e]xercising any of the options provided in III.H of the Final Judgment." Thus, the judgment does in

fact prevent Microsoft from offering financial incentives to OEMs not to install and ship competing non-Microsoft middleware.

- Q4. *One important issue the settlement was intended to address was Microsoft's ability to penalize computer makers that load non-Microsoft software onto their machines. Under the settlement, can Microsoft still bar a computer maker from putting WordPerfect word processing software or Quicken financial software pre-installed on their machine? If so, why isn't Microsoft's ability to place such restrictions on computer makers a problem for competition?*
- A. Microsoft has never kept a computer maker from loading either WordPerfect or Quicken (or any other application) on machines it sells. Indeed, a quick review of any computer retailer indicates the variety of applications installed by OEMs on the PCs they sell. The reason that the Revised Proposed Final Judgment does not place such restrictions as you mention on Microsoft is that no part of the case against Microsoft had anything to do with conduct by Microsoft that was intended to, or did, have any exclusionary impact on non-middleware applications such as word-processing and personal-finance software. And there is no plausible argument that extending relief to such non-middleware applications has a connection to the theory of the Department's case against Microsoft.

#### Durbin Questions

- Q1. *This is an unprecedented settlement for an unprecedented case. The entire world has been, and will continue to, watch every aspect of this case. They will also be watching to see if Microsoft complies with every word of this decree. Assuming this settlement is approved, can you outline the steps that will be taken to ensure compliance with the settlement? Are these steps unique in any way?*
- A. Microsoft has made a company-wide commitment to comply with the settlement entered in this case. The Revised Proposed Final Judgment contains strong enforcement provisions that include internal compliance efforts within the company. As stated in my testimony, Microsoft already had one of the largest and most talented in-house legal teams in the country, and the recent hiring of new compliance specialists will further enhance that team. From the very highest levels of the company, Microsoft is eager to settle this matter and move forward, and has every intention of meeting its settlement obligations to avoid any further disruption of its business. Business executives, developers and lawyers are hard at work at Microsoft implementing every aspect of the Revised Proposed Final Judgment. Microsoft has provided extensive training on the settlement to its lawyers and key business and development employees throughout the world. Senior personnel are meeting on a weekly basis to manage everything Microsoft must do to comply with the settlement, including identifying and documenting new APIs and new Communications Protocols and designing and developing new software for the upcoming Service Pack release of Windows XP to facilitate removing access to key Windows features. Microsoft has already implemented

the OEM provisions of the settlement, establishing new uniform Windows license terms for its OEM customers, making those terms available to the Department and the states for their review, and so forth.

Q2. *What assurances can the American people have that Microsoft will really be constrained from future anti-competitive practices?*

A. As stated in my testimony, the Revised Proposed Final Judgment as agreed between Microsoft, the Department and the settling states provides very strong relief and unprecedented enforcement mechanisms. The Revised Proposed Final Judgment goes well beyond the practices at issue in the underlying case and will change in significant ways the manner in which Microsoft does business. Microsoft has made full compliance with the Revised Proposed Final Judgment a top priority. As mentioned in response to an earlier question, Microsoft has never been found to have violated its previous antitrust decree.

### Responses to Questions from Senator Hatch:

**Question #1:** Both commentators and several witnesses (in their written testimony) defend the Proposed Settlement by arguing that its terms are as good as – or even better than – what would have been obtained through further litigation. Several have also pointed out that it would take at least two more years to get a remedy in place by means of litigation. Could you please explain whether and why you believe that further settlement negotiations or litigation would be in the public interest?

**Answer:** A settlement of established antitrust violations is desirable only insofar as it remedies past misconduct or promotes future competition. The Proposed Settlement unfortunately does neither. Even as to the desktop PC market it contains numerous loopholes, and critically omits any objective enforcement mechanism to incent compliance. Given Microsoft's proven track record of circumventing the 1995 consent decree, this risks gutting even the limited remedies set forth in the Proposed Settlement. The Proposed Settlement also flatly fails to deal with the increasingly important arena of new devices (cell phones, PDAs, set-top boxes, and home entertainment centers) into which Microsoft is extending its desktop operating system and applications monopolies through many of the same improper technical and contractual means it used to obtain dominance in the desktop PC arena. Absent stronger and wider protections for consumers, litigation would be the only viable alternative to protect consumer interests.

**Question #2:** In light of the number of claims from the original complaint that the D.C. Circuit found to lack merit, is it reasonable to believe that any judgment resulting from further litigation would be significantly better than the Proposed Settlement?

**Answer:** While the D.C. Circuit did not affirm every finding of liability against Microsoft, and the Department of Justice has elected not to pursue certain causes of action that were remanded, the case against Microsoft is still compelling. The D.C. Circuit affirmed the district court's central finding that Microsoft has a monopoly and has acted improperly to protect that monopoly by undermining competitive threats like Netscape's Navigator web browser and Sun's Java programming language. As I understand it, the Supreme Court and the D.C. Court of Appeals have both held that a reviewing court has the obligation to ensure a remedy for proven antitrust abuses should end the illegal monopoly, undo the anticompetitive effects, and prevent future practices likely to lead to future monopolization. For the reasons noted, the Proposed Settlement falls well short of these objectives.

**Question #3:** At the hearing, I emphasized the need for prompt antitrust enforcement in quickly evolving markets. Could you please explain whether and why you believe that the benefits of having an imperfect settlement now are outweighed by those of having a possibly better settlement at some point in the future?

**Answer:** It is precisely because the Proposed Settlement is a backwards-looking document that fails to deal with current and emerging competitive abuses that we need a more efficient and forward-looking remedy. Failing to address new markets at this point would permit Microsoft to re-enact its repeated monopolistic conduct, extending its improper monopoly

## Responses to Questions from Senator DeWine

**Question #1:** The Proposed Final Judgment aims to make the middleware market more competitive. Do you believe it is effective in doing so?

**Answer:** For the reasons noted in my written testimony, I am confident that the Proposed Final Judgment will not encourage competition in the market for middleware. The Proposed Final Judgment fails to meaningfully limit Microsoft's ability to use its tremendous market power to retaliate against companies whose conduct threatens that market power. As a result, original equipment manufacturers are highly unlikely to adopt middleware products that compete with Microsoft's products or anticipated product extensions.

Moreover, much of the Proposed Final Judgment focuses on original equipment manufacturers, while the locus of control has largely moved to the operating system and to the networks to which it links (such as MSN). Controlling the operating system and the linked networks gives a company the ability to prompt users to make upgrades and accept default programs and features. The Proposed Final Judgment gives Microsoft all the latitude it needs to prompt consumers at every turn in order to ensure that the easiest path to middleware software is always the Microsoft path.

Similarly, Microsoft is building on its operating system monopoly through initiatives such as Passport and Hailstorm, establishing a dominant share of consumer identity information, which acts to further lock-in consumers to the use of Microsoft middleware across a variety of devices and networks.

**Question #2:** Do you believe Microsoft will be able to leverage its monopoly in the PC operating system market to capture market share in other operating systems markets such as hand-held devices, navigation devices, and servers? Does the proposed settlement address this issue at all, and do you believe that Appellate Court's ruling would permit a settlement that address these types of concerns?

**Answer:** Microsoft's ability to improperly extend its monopoly to new areas is a significant cause for concern. Microsoft was convicted of illegally protecting its desktop PC monopoly against threats from Netscape's Navigator browser and Sun's Java programming language, innovative new products that each had the potential to reduce Microsoft's monopoly dominance of the computing environment. Given the increasing importance of the interoperability of different consumer-oriented computing environments (desktop PCs, client-server network operating systems, small devices, and home entertainment systems), control over the broader computing environment is critical to preserve Microsoft's dominance into the future. Many of these devices operate in client-server configurations, in which Microsoft's PC desktop operating system dominance gives it an advantage in the server market, and thus an advantage in writing software for any other devices that need to access those servers.

On the other hand the emergence of non-Microsoft-dominated software could pose a serious potential threat to Microsoft's ability to dominate this wider computing environment – just as Navigator and Java did a few years ago. The combination of network externalities



resulting from the creation and protection of Microsoft's existing operating system and application monopolies -- together with the likely repetition of Microsoft's improper technical and contractual misconduct in these new markets -- poses a critical problem for competitors and consumers.

The Court of Appeals ruling expressly authorizes, and in fact calls for, a remedy that not only redresses past misconduct but also deters practices likely to extend the anticompetitive effects of the improper monopoly into the future. The Proposed Final Judgment fails to do so and sets the stage for a continued stifling of innovation.

## Responses to Questions from Senator Kohl

**Question #1:** Do you believe that this settlement is adequate to restore competition in the computer software industry? Why or why not?

**Answer:** No. The Proposed Settlement fails to include remedies that will restore any meaningful competition to the markets in which Microsoft improperly established its monopolies, fails to include any objective or efficient sanctions for non-compliance with its terms, and fails to address the emerging consumer markets (such as those for small devices such as PDAs, cell phones, television set-top boxes, and home entertainment centers) in which Microsoft is improperly expanding its monopolies.

**Question #2 (a):** Are there any restraints on Microsoft's conduct which you think should be in the settlement but are not? Is so, what are they?

**Answer:** Yes. The remedies proposed by the non-settling states would be far more effective than the Proposed Settlement in redressing prior abuses and restoring competition to the market. As set forth in my original written testimony, my perspective at Liberate gives me special insights into the need for several of these remedies:

- ◆ **Review of Microsoft Investments.** Investing the considerable proceeds of its desktop monopoly in new markets, Microsoft has extracted, or attempted to extract, exclusive or near-exclusive commercial distribution arrangements to block out competitors. In the interactive television industry alone, Microsoft has invested billions of dollars with leading cable and satellite networks. The strings attached to these investments often require networks to buy Microsoft's middleware, making it difficult or impossible for them to buy competitive products.
- ◆ **Prevention of Anticompetitive Conduct in Non-Desktop PC Markets.** The Proposed Final Judgment focuses only on Windows products for desktop PCs and includes broad and ambiguous exceptions to its limits on retaliation. These loopholes would apparently let Microsoft get away with the kind of misconduct it perpetrated against Liberate Technologies when it was known as Network Computer. The result would be to block or delay the development of new competitive devices and technologies. The remedy proposed by the non-settling states would, on the other hand, prevent Microsoft from using this type of retaliation to unfairly extend its desktop monopoly to a wider array of software and devices, while more adequately opening Microsoft's technical standards to prevent it from excluding rival software companies from meaningful competition.
- ◆ **Prevention of Efforts to Block Non-Proprietary Standards.** Microsoft has also abused its monopoly position by blocking industry-wide standards essential to the evolution of a new generation of network-based devices. In our industry, Microsoft has undermined the Java programming language as a standard for digital television, lobbying heavily to prevent U.S. and European standards bodies from standardizing on Java. As you know, Java lets developers "write once, run anywhere", permitting

content to run across a wide variety of platforms rather than just on Microsoft's proprietary code.

Moreover, by removing the Java Virtual Machine from its PC operating systems while the JVM is common elsewhere, Microsoft discourages developers from creating new "write-once, run-anywhere" content, undermines support for uniform standards, and drives developers to write to proprietary Microsoft platforms. Microsoft's foot-dragging and affirmative interference has slowed the deployment of digital television in the United States. Cable companies and television manufacturers both say that such deployment has been slowed by lack of a definitive standard, a standard that Microsoft's tactics have delayed and undermined. Microsoft's approach stands in direct opposition to the clearly expressed will of Congress and the interests of all Americans interested in richer and more varied television programming.

**Question #2(b):** Beyond restraints on Microsoft's conduct, are there other deficiencies in the proposed consent decree which you believe should be fixed before it is approved? If so, what are they?

**Answer:** The critical gap in the Proposed Settlement in this regard is the lack of an objective or effective enforcement mechanism. Per the recommendation of the non-settling states, I would recommend that the district court consider using a technically knowledgeable outside advisor to review claims of Microsoft non-compliance with the terms of any consent decree. Moreover, and critically, the sanctions for violation of the terms of the decree must go beyond the mere extension of those terms for a relatively brief additional period.

**Question #3:** Critics of this proposed settlement argue that one significant loophole is that many of the provisions requiring Microsoft to permit computer users and manufacturers to install competing software and remove Microsoft software do not apply with respect to software that has distributed less than one million copies. Are you concerned about this limitation? Won't this provision make it difficult for small or start-up software manufacturers that make software that competes with Microsoft's products to gain access to the computer desktop?

**Answer:** As Bill Gates himself has said, the greatest competitive threat to Microsoft's dominant position comes not from existing competition, but from the kid tinkering in his garage, designing seminal new software that might revolutionize the industry. Unfortunately, the one-million-copy threshold makes it a terrifically uphill battle for those kinds of revolutionary ideas to get traction and take hold. Without access to critical information about Microsoft's products, it will be extremely difficult for any new competitor to make its product operate successfully in a Microsoft-dominated computing environment. As a result, venture capitalists will be loath to support any small company that seeks to compete with Microsoft – no matter how attractive its innovation.

By way of example, Liberate Technologies was itself until recently a fledgling start-up. It took us five years and a difficult decision to exit a line of business (network computing)

dominated by Microsoft before we were able to reach the benchmark of distributing one million copies of our software. In today's environment, with Microsoft's additional market power, we simply would not have been able to reach that point.

In sum, the million-copy threshold, coupled with the failure to effectively redress Microsoft's existing market dominance, will certainly stifle promising next-generation innovations.

**Association for  
Competitive Technology**

January 14, 2002

The Honorable Patrick Leahy  
Chairman  
United States Senate  
Dirksen Senate Office Building, Room 224  
Washington, DC 20510

VIA FACSIMILE AND ELECTRONIC MAIL

Dear Chairman Leahy:

I want to thank you again for the opportunity to appear at last month's hearing to testify on how the Revised Proposed Final Judgment (RPFJ) in United States v Microsoft, will affect consumers and the information technology (IT) industry. I have received the written questions from members of the Committee and I'm pleased to provide responses that will not only complete the record but also provide the perspective of the small high technology companies that represent the majority of the industry.

**Responses to Questions from Senator Hatch**

1. There is no doubt that bringing this protracted litigation to a close is in the best interests of the IT industry and consumers. Settling the case removes a cloud of uncertainty and allows companies large and small to focus on innovating to meet consumer demand. Further litigation is not likely to produce any remedial actions that: a) are not already covered by the RPFJ and responsive to the Court of Appeal's ruling, or b) would be in the interests of the industry, save a few Microsoft rivals. As demonstrated by the very nature of the proposed "remedies" that will be part of ongoing litigation, it is clear that the RPFJ presents an appropriate and balanced resolution of this case. I agree with Assistant Attorney General Charles James when he noted at a November 2, 2001 press conference, "[t]he settlement is consistent with the relief we believe we might have obtained in litigation. This settlement, however, has the advantages of immediacy and certainty."
2. It is very unlikely that a judgment borne of continued litigation will be marginally, let alone "significantly" better than the RPFJ. As you point out in your question, the Court of Appeals has dramatically reduced the finding of liability against Microsoft. The conduct restrictions, coupled with the additional enforcement measures such as the creation of a Technical Committee, more than adequately address the anticompetitive behavior identified by the Court of

Helping Washington Get IT.

Appeals. I include the following table to show precisely where the RPFJ addresses each finding:

Findings of Anticompetitive Conduct by the Court of Appeals	Settlement Section
Limiting promotion of browsers or restricting OEMs from modifying the initial boot sequence	III.C, III.G.1, III.H
Prohibiting deletion of the Internet Explorer icon	III.H.1-3
Commingling Internet Explorer & Windows code without providing a simple mechanism for OEMs and users to remove access to Internet Explorer	III.H.1-3
Restrictions on the promotion and distribution of competing web browsers by Internet Access Providers	III.A.1, III.C.1-2
First-wave requirements for software vendors to use Microsoft's Java Virtual Machine	III.F.2
First-wave requirements for software vendors to use Internet Explorer	III.G.1
Leveraging MS Office to induce Apple to feature Internet Explorer	III.G.2
Misleading Java Developers	III.D
Pressuring Intel to end their Java Virtual Machine development	III.F.1

- On balance, this settlement is good for our industry. We agree with the Senator that the RPFJ is not perfect. In fact, as pointed out in my written testimony, ACT believes that the provisions mandating disclosure of server protocols and the creation of the Technical Committee are beyond the finding of liability and may set an inappropriate precedent for future antitrust cases in the information technology industry. That said, it is important to point out that this case is nearly four years old and has shrouded the entire IT industry in a haze of uncertainty. At present, the technology industry - which has been the engine for much of the recent economic growth - cannot realize its full potential in the uncertain environment this case engenders. Those who seek to prolong this case for their own benefit are, at a minimum, guilty of making the perfect the enemy of the good.

#### Responses to Questions from Senator DeWine

- One important lesson to be learned from this case is that antitrust principles apply to the IT industry. The RPFJ is proof that antitrust principles, when applied properly, can work to restore competition within the IT industry. For example, the settlement will stimulate competition by giving greater flexibility to computer manufacturers and users to choose among different middleware and operating systems.

With respect to what to say to Netscape, I would hardly consider them "defeated." After building a 85% market share, the company was acquired by America Online for \$10 billion dollars and continues to be a viable browser with millions of loyal users. More importantly, Netscape should be congratulated for winning one its biggest arguments - the browser as a platform threat. It is clear that the browser has emerged as a platform competing against operating systems for application hosting. The popularity of browsers (including Navigator) and browser-based applications evidences this fact. Therefore, we should tip our hat to the Netscape

Robert G. Ristroph  
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December 23, 2001

Renata B. Hesse  
Antitrust Division  
U.S. Department of Justice  
601 D Street NW  
Suite 1200  
Washington, DC 20530-0001

Dear Ms. Hesse,

I am writing with regard to the Justice Department's proposed settlement with Microsoft. I believe that this settlement should be scrapped and completely rewritten. Most of the "restrictions" placed on Microsoft are already illegal; what few restrictions are left are impossible to enforce and seem designed to produce more legal disputes rather than resolve them; and the proposed enforcement mechanism is a ludicrous embarrassment. In addition to scrapping this proposed settlement, any payment or further employment of the authors should be re-evaluated in light of this idiocy.

I have read the original complaint of United States and the several States at <http://www.usdoj.gov/atr/cases/f1700/1763.htm>, the proposed settlement at <http://www.usdoj.gov/atr/cases/f9400/9495.htm>, the Competitive Impact Statement at <http://www.usdoj.gov/atr/cases/f9400/9495.htm>, as well as numerous other sources including the findings of fact and other documents.

My own injury by Microsoft's illegal actions comes from Microsoft's agreements with OEM's which forced my employer to pay for Windows when buying a new computer from Dell, which we had no plans to use Windows, intending it for Linux. This was supposedly addressed in a prior case to the present one, and yet to this day the same hardware without a Microsoft license has the same cost.

I wish to examine the elements of the proposed agreement item by item, and then propose an outline of an alternative settlement.

A. That Microsoft will not retaliate against OEMs for distributing non-Microsoft software. This is already prohibited by law, given Microsoft's monopoly. The proposed settlement can not consist of Microsoft agreeing to follow the law in the future; like other companies in the United States, it has to follow the law regardless of this settlement.

B. That Microsoft make public it's licensing agreements and offer the same

terms to everyone. This is the only part of the proposed settlement makes sense, however, OEMs have shown in the past they were willing to collaborate in Microsoft's illegal activities. Should Microsoft offer an OEM a secrete payback or special deal, the cooperation of the OEM will make this section difficult to enforce.

C. That Microsoft cannot restrict certain OEM software through agreements. This is already illegal, like A.

D. Some meaningless nonsense not worthy of comment or the paper it is printed on.

E. That communications protocols in Microsoft software be publicly available. In light of Microsoft's previous behavior in exploiting secrete calls in it's software, all of it's source code should be available for public examination. The suggestion that only "communications protocols" be public is problematic because it leaves open to dispute what consists of a communications protocol. This is foolish given Microsoft's previous self-serving interpretations of court orders.

F. That Microsoft will not retaliate against software vendors for competing against them. This is already against the law given that Microsoft is a monopoly.

G. That fixed percentage distribution agreements be banned. This is already against the law. The exceptions listed in this paragraph are also against the law, creating the suggestion that the United States will enter into an agreement with Microsoft to allow it to break the law in some cases.

H. That OEMs and users are allowed to configure the Microsoft software they buy. This is vague and confusing because it is difficult to precisely describe what consists of configuring software, and thus impossible to reliably enforce. In a competitive market it would be the natural case, and the proposed settlement should focus on restoring competition.

I. That Microsoft offer licenses to "intellectual property" necessary to allow others to exercise "alternatives provided under this final judgment." The reference to alternatives provided to others contradicts the final section of the proposed settlement, which explicitly denies that the final settlement gives any rights to third parties. Even aside from that, this section probably denies behavior already illegal, is riddled with exceptions, vague, and seems designed to produce legal action rather than remedy.

J. A section devoted wholly to exceptions for Microsoft, as if there where not enough already.

The Enforcement Authority:

A. Access to source code is probably one of the best remedies. The exceptions and limitation of this access to a committee are silly.

B. The Technical Committee. It has too few members, it should be composed of



Officers of a United States Federal Court in order to make it's requests immediately enforceable through Contempt hearings, and the gag on public statements renders the whole committee useless. The further restriction that the testimony of this muzzled and hobbled committee not be admissible in court is a bit like shooting the deer after it's tied down with it's throat cut.

C. The Microsoft Compliance Officer. This section is nonsense. Other companies manage to obey the law without the use of a special office. If Microsoft needs one they can implement it without a judgment.

D. Voluntary Dispute Resolution. This section seems dedicated to stipulating that various parties send each other letters before seeking court hearings, a common practice. 4(d) guts all enforcement power from the proposed judgment, and suggests that the Attorneys for the Justice Department don't believe in their own system of courts.

#### Third Party Rights:

This section is in contradiction with other references to the submission of complaints to the Technical Committee and the requirement that Microsoft offer "intellectual property" licenses to the third parties so that they can pursue the alternatives guaranteed them in this proposed final judgment.

In summary, this proposed final judgment is a poor sham for a capitulation by the Plaintiffs. It's not even a good surrender, because it's vagueness and self-contradictions guarantee more legal action; if we must capitulate, at least we should save on legal costs. It also completely fails to disguise the capitulation in any way. This is why whoever wrote it should be fired, even if the Justice Department unwisely chooses to fail to enforce the law as applies to Microsoft.

A real final judgment, which might have the chance of remedying the situation, would have to be in some way "self enforcing." By "self enforcing" I mean that the remedy by it's nature should preclude further legal wrangling and evasion efforts by Microsoft. Stipulations on Microsoft's future behavior inherently have to be enforced, and thus are not well suited to this case. Furthermore, when the proposed judgment stipulates that behavior already illegal be banned and then suggests exceptions, the Plaintiffs are acquiescing in further law breaking by Microsoft.

An example of a "self enforcing" remedy would be denying Microsoft copyright protection. No Technical Committee is required; all that is needed is to reject out of hand cases of copyright enforcement that Microsoft brings. Thus, revoking copyright privileges for some portion of the works that Microsoft used to violate the law might be an appropriate remedy. Or perhaps Microsoft could post substantial bonds against it's future behavior.

*Many of the major flaws in this proposed final settlement result from the needless use of vague and disputable terms, when simple and undisputable ones would do.*

Replace all references to "Microsoft Middleware" "Windows Operating System Product" and such with the simple phrases "products of Microsoft" and "products of third parties." Avoid even the use the term "software products," as Microsoft would produce hardware required to run their products and then violate the agreement. Be sure the phrase "products" is defined to mean anything Microsoft does, including services.

Replace all references to "ISVs, IHVs, ICDs, OEMs" and such with the phrase "any third party." Quibbling over which member of the alphabet soup a particular entity fell under is thus eliminated. The final judgment should require no differentiation between the various consumers and companies interacting with Microsoft. This also remedies the fault that the current proposed judgment allows Microsoft to exempt any third party from the benefits of what legal behavior is required by claiming they do not have a viable business plan.

I hope you find these suggestions helpful in writing a real judgment.

Sincerely,

A handwritten signature in black ink, reading "Robert G. Ristroph". The signature is written in a cursive, slightly slanted style. The first name "Robert" is written in a larger, more prominent script, followed by "G." and "Ristroph".

Robert G. Ristroph

RENATA B. HESSE  
ANTITRUST DIVISION  
U.S. DEPARTMENT OF JUSTICE  
601 D STREET NW  
SUITE 1200  
WASHINGTON, DC 20530-0001

10 DECEMBER, 2001

Dear Renata B. Hesse,

I am a concerned citizen, unwilling Microsoft customer forced to use their unpleasant products because of their unassailable monopoly, and a long time member of the computer industry.

I am writing to you to protest the terms of the Proposed Final Judgement, in specific the failure of this Judgement to address the pivotal role that the open software movement has played in the genesis of the Internet age, and its legitimate ongoing contributions which are ignored by the Judgement's terms and will be harmed by the Judgement's execution.

To enumerate but three of thousands of valuable not for profit software development efforts which remain critical to the ongoing viability of the net and which will be harmed by the Proposed Final Judgement because they are beneficiaries of neither Section III(J)(2) under (c) as meet[ing] reasonable, objective standards established by Microsoft for certifying the authenticity and viability of its business,... nor under Section III(D) as the footnotes hold this section in force only to commercial concerns:


Apache is the Internet server that made the net possible. It is the most viable competitor to IIS, Microsoft's server architecture. Without Apache the net would grind to a halt. There is no commercial contender to IIS, the entire competitive landscape is between IIS and Apache and a few other open source servers. Since IIS is stunningly, almost fraudulently insecure, the Proposed Final Judgement weakens the Nation should it not aggressively protect the better engineered open source efforts from Microsoft's predatory tactics.

BSD, especially in its most popular flavor freeBSD, and its younger but bigger brother Linux present a real and viable challenge to Microsoft in the server market, are gaining in the workstation market, and would, if they could be made compatible with Microsoft's industry crushing Office, be a viable contender on the desktop. These efforts are undertaken in that most American of spirits: for the good of all. They provide real alternatives to Microsoft; significant and meaningful improvements in performance and security to users who appreciate these things when compared to Microsoft's invariably flawed products, and competition which is perhaps Microsoft's only remaining motive for fixing its failures. While major security holes are exposed in IIS every month or so, despite Microsoft's efforts to sweep them under the rug, no security hole has been discovered in NetBSD in more than four years. These superior products are run without marketing and lobbying budgets and will be crushed by Microsoft which will endeavor to make them as incompatible as possible with their desktop monopoly (if their efforts to make them outright illegal fail).

This message will reach you through one or many servers running Sendmail. A near perfect application which relies on free and open standards established for the routing of electronic mail. Since Microsoft will be under no obligation to share standards with the not-for-profit organization that maintains Sendmail, it is quite certain that Microsoft will do whatever they can to force all Sendmail administrators to switch to an expensive, fault ridden Microsoft product, leveraging their monopoly on the desktop to do so unless the DOJ alters the Proposed Final Judgement to protect open source at least as effectively as it protects whatever pathetic vestiges of the commercial market still stand to challenge Microsoft's otherwise unassailable monopoly.

The Proposed Final Settlement fails utterly to address the critical role of the open source movement and is therefore utterly unacceptable to me as a harmed party.

Sincerely,



David Gessel

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INSURANCE & CONSUMER PROTECTION  
REDISTRICTING  
RURAL DEVELOPMENT  
TRANSPORTATION

January 9, 2002

Ms. Renata B. Hesse  
Antitrust Division  
U.S. Department of Justice  
601 D Street NW, Suite 1200  
Washington, DC 20530-0001

Via facsimile: (202) 307-1454

Re: Support for Microsoft Settlement

Dear Ms. Hesse:

I am writing to express my support for the settlement that the Department of Justice and several states, including North Carolina, have reached with Microsoft.

I will be pleased to see this matter resolved because it will be a boost for the technology sector, a larger force in the North Carolina economy. I believe that the certainty of the settlement will promote new investment in technology and will enhance competition in all aspects of the technology industry which will benefit consumers. With this litigation settled, the technology industry can continue its recovery and growth.

The settlement represents a reasonable compromise that has earned bipartisan support. I urge the Department of Justice and the court to approve this settlement.

Sincerely,

Senator Scott Thomas

ST/cbj

